BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ARCO Products Company, Mobil Oil Corporation, Texaco Refining and Marketing, Inc., and Equilon Enterprises, LLC, Complainants, vs. Santa Fe Pacific Pipeline, L.P., Defendant.	C. 97-04-025
And Related Matters.	C. 00-04-013 A. 00-03-044 A. 03-02-027 A. 04-11-017 A. 06-01-015 A. 06-08-028 C. 06-12-031

CONCURRENT OPENING BRIEF OF SFPP, L.P.

GOODIN, MACBRIDE, SQUERI, DAY & LAMPREY, LLP
James D. Squeri
505 Sansome Street, Suite 900
San Francisco, CA 94111
Telephone: (415) 392-7900
Facsimile: (415) 398-4321
E-Mail: jsqueri@goodinmacbride.com

Date: April 26, 2007

Attorneys for SFPP, L.P.

TABLE OF CONTENTS

				Page
CONCURRENT OPENING BRIEF OF SFPP, L.P.				1
I.	INTRODUCTION			2
II.	SUMMARY OF SFPP'S POSITIONS AND RECOMMENDATIONS			7
	A.	Electricity Surcharge Issues		7
	B.	2003 TY Cost of Service Issues		8
	C.	Watson Station Volume Deficiency Charge and Sepulveda Line Issues		9
III.	ARGUMENT			10
	A.	SFPP Is Entitled to Retain All Electricity Surcharges That It Has Collected Since October 24, 2002.		10
		1.	Advice Letter No. 14's Forecast of a $5.77 Million Annual Increase in Power Costs Is Reasonable, and SFPP's Switch from Bundled Utility Service to Direct Access Service Has No Impact Upon the Reasonableness of the Estimated Increase in Power Costs	12
		2.	SFPP's 2003 TY Cost-of-Service Showing, Which Includes Its Electricity Surcharge Revenues, Clearly Demonstrates that SFPP Is Not Overearning and Is Therefore Entitled to Retain All of Its Electricity Surcharges Collected Since October 24, 2002.	16
	B.	Based Upon A 2003 Test Year Analysis of SFPP's Cost of Service, It Is Clear That SFPP's Rates For the Period From January 1, 2004 to December, 2004 Including Rates Associated with the Electricity Surcharge, Watson Station, and the Sepulveda Line, Are Reasonable.		17
		1.	The North Line Expansion Is a Valid Test Year Cost-of Service Adjustment.	19
		2.	There Is No Legal, Factual, or Policy Basis to Deny SFPP a Full Income Tax Allowance.	25
		3.	SFPP's Assumed Rate of Return for Test Year 2003 Is Reasonable.	34
			a. SFPP's assumed capital structure is reasonable	35
			b. SFPP's assumed cost of debt is reasonable	37
			c. SFPP's assumed cost of equity is reasonable	38

TABLE OF CONTENTS
(continued)

Page

4. SFPP's Allocation of Test Year General and Administrative ("G&A") Expenses Incurred by KMEP on Behalf of SFPP Is Reasonable. 43

a. SFPP's allocation of KMEP overhead to SFPP California jurisdictional operations is reasonable. 45

(1) The Massachusetts Formula vis-à-vis KMEP's 2002 10-K Report 45

(2) Unjustified reduction of the gross property factors of the Massachusetts Formula by removing purchase accounting adjustments 48

b. SFPP's allocation of overhead costs between carrier and non-carrier operation is reasonable. 49

5. SFPP's Test Year Estimate for Fuel and Power Expense Is Reasonable. 50

6. SFPP's Adjustment of Test Year Expenses Related to Oil Losses & Shortages Is Reasonable. 54

7. SFPP's Adjustment of Its Cost of Service to Reflect DR&R Expenses Is Justified. 56

a. Illegitimacy of the argument that SFPP is not incurring DR&R expense at this time 59

b. The relevant time period is not just when SFPP ceases operation 61

8. SFPP's Test Year Estimate of Throughput Volumes Is Reasonable. 62

9. The Reasonableness of SFPP's Forward-Going Rates On a Cost-of-Service Basis Is Further Validated by Consideration of the UNOCAP Factors. 66

C. No Portion of Any Rates Collected by SFPP for Services Related to Its Watson Station and Sepulveda Facilities Is Unreasonable or Otherwise Subject to Refund 73

1. The Rates Charged by SFPP for Services Related to Watson Station and Sepulveda Facilities for the Period Through December 31, 2003 Are Reasonable. 74

TABLE OF CONTENTS
(continued)

Page

a. Market conditions, including the availability of sufficient competitive alternatives, support a Commission finding that 5¢/bbl. is a reasonable rate for Line 109 (the "Sepulveda" line). 76

b. The 3.2¢/bbl. Watson Station Volume Deficiency Charge is reasonable. 82

2. Rates Charged by SFPP for Services Related to Watson Station and Sepulveda Facilities for the Period From January 1, 2004 Forward Are Reasonable........ 89

IV. CONCLUSION........ 89

TABLE OF AUTHORITIES

Page(s)

STATUTES

Pub. Util. Code §366.2, subd.(d)(1) 15

CASES

Pacific Telephone and Telegraph Company v. Public Utilities Commission, (1965) 62 Cal.2d 634 .... 20, 21

DECISIONS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION

65 CPUC2d 613 .... 85, 88, 89

City of Long Beach v. Unocal California Pipeline Company, 66 CPUC2d 28 ("UNOCAP") 74, 80

D. 01-09-060 15

D. 02-03-055 15

D. 02-04-067 16

D. 02-07-032 51

D. 02-11-022 .... 16, 52

D. 03-04-030 15

D. 92-05-018 2

D. 92-12-085 28

D. 96-04-056 87

D. 99-06-093, 1999 Cal. PUC LEXIS 442, *4-5 .... *in passim*

Income Tax Expenses for Rulemaking Purposes (1984) 15 CPUC2d 42 27

FEDERAL ENERGY REGULATORY COMMISSION ORDERS

Enbridge Pipelines (KPC), 102 FERC ¶ 61,310 (2003) 58

TABLE OF AUTHORITIES
(continued)

Page(s)

Endicott Pipeline Company, 55 FERC ¶ 63,028 (1991) 58, 60

Kuparuk Transportation Co., 55 FERC ¶ 61,122 (1991) 58, 62

Policy Statement on Income Tax Allowances, May 4, 2005, 111 F.E.R.C. P61,139; 2005 FERC Lexis 1129 29

White Shoal Pipeline Corp., 38 FERC ¶ 62,287 (1987) 58

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ARCO Products Company, Mobil Oil Corporation, Texaco Refining and Marketing, Inc., and Equilon Enterprises, LLC, Complainants, vs. Santa Fe Pacific Pipeline, L.P., Defendant.	)	C. 97-04-025
And Related Matters.	)	C. 00-04-013 A. 00-03-044 A. 03-02-027 A. 04-11-017 A. 06-01-015 A. 06-08-028 C. 06-12-031

CONCURRENT OPENING BRIEF OF SFPP, L.P.

In accordance with the procedural schedule established by the presiding administrative law judge ("ALJ"), SFPP, L.P. ("SFPP") hereby respectfully submits its Opening Brief addressing issues presented by A. 03-02-027, the pending proceeding for establishing the reasonableness of its existing, intrastate pipeline transportation rates.[1]

As more fully argued below and as supported by the record, it will be shown that: SFPP is entitled to retain $5.77 million of annual electricity surcharges collected between October 24, 2002 and January 1, 2004, whether the reasonableness of the surcharge is reviewed under the Commission's traditional after-the-fact rate review standard or in the context of a test

[1] By e-mail dated April 9, 2007, ALJ Long extended the date for filing of opening and reply briefs in these consolidated proceedings from April 16, 2007 to April 26, 2007 and from May 7, 2007 to May 17, 2007, respectively.

year cost of service analysis. The record also demonstrates, based upon a forward-looking 2003 Test Year ("TY") cost of service showing, that SFPP's overall, systemwide intrastate rates, including electricity surcharges and specific charges related to its Watson Station and Sepulveda pipeline facilities, remain reasonable for the period from January 1, 2004 forward. Finally, the record supports a finding that the specific charges collected by SFPP prior to January 1, 2004 with respect to its Watson Station and Sepulveda pipeline facilities were at all times reasonable.

When further consideration is given to the less rigid ratemaking methodology applicable, under existing Commission policy, to oil pipeline corporations such as SFPP, it is demonstrably apparent that SFPP's rates have been and remain just and reasonable.

I. INTRODUCTION

It is important to place A. 03-02-027, which is essentially the first general rate case review of SFPP's rates in over a decade, in context. In D. 92-05-018 issued on May 8, 1992 in A. 91-12-034, the Commission authorized a 9% increase in rates for SFPP and a 13.54% return on equity. It would be twelve years, almost to the date, until SFPP filed for its next rate increase, requesting a $5.77 million annual increase to reflect and offset higher electric power costs associated with California's energy crisis of 2000-2001.[2] The unrebutted evidence in A. 03-02-027, in addition to common sense, supports the conclusion that SFPP's electric power costs, irrespective of whether they were incurred as a bundled utility customer or a Direct Access customer, did increase as a result of California's energy crisis and in a manner entirely consistent with the forecasted $5.77 million annual increase in electricity costs that was the subject of Advice Letter No. 14.

[2] Advice Letter No. 14, which is the subject of Resolution O-0043 which, in turn, gave rise to A. 03-02-027, was filed on May 10, 2001.

Given that the rates at issue in A. 03-02-027 reflect base rates that have previously been approved by the Commission in 1992 and an electricity surcharge which reflects universally recognized increases in California electricity costs, there is no justification for the astounding claim of Indicated Shippers that SFPP rates have nevertheless become unreasonable and excessive in the amount of $32.6 million. To arrive at their absurd and counter-intuitive construct in which SFPP is over-recovering its cost of service by more than $30 million, Indicated Shippers rely on three, principal devices – two of which are illegal and one that is without record support.

First, Indicated Shippers propose a radical change in existing Commission policy regarding treatment of federal income tax allowances for ratemaking purposes that would deny recovery of any income tax allowance in SFPP rates. Indicated Shippers not only recommend adoption of a discredited tax allowance policy that has not been endorsed by any regulatory body, state or federal, but they would have the Commission unlawfully and retroactively apply the unprecedented policy to SFPP alone.

Secondly, in direct contravention of state law as articulated by the California Supreme Court, Indicated Shippers would exclude SFPP's North Line Expansion Project from inclusion in SFPP's 2003 Test Year ("TY") analysis based upon the patently incorrect theory that only costs actually incurred or reasonably certain to be incurred in 2003 may be included in development of SFPP's 2003 TY cost of service. This recommendation of Indicated Shippers is particularly pernicious because of its willful disregard of the facts that: (i) SFPP has not had a general rate case since 1992; (ii) its 1992 rate base, on which SFPP is entitled to earn a return, has been substantially reduced by annual depreciation over the past twelve years during which there were no major plant additions; (iii) pipeline infrastructure additions are, by nature, notoriously "lumpy" investments, i.e. large but irregularly periodic capital expenditures; and (iv) when A. 03-02-037 was filed, it was known to a relative degree of certainty that the North Line Expansion Project was under construction and therefore properly includable in SFPP's 2003 TY cost of service. It is both unfair and irrational to evaluate the reasonableness of the rates of a public utility like SFPP (that does not regularly file general rate case applications) by freezing rate base investment as of the time of review and ignoring new rate base expenditures that are indisputably occurring within the TY forecast period.

Finally, Indicated Shippers pursue the rigid application to SFPP of an overly strict and inappropriate cost-of-service methodology that relies on an array of esoteric assumptions that are not supported by the record. Indicated Shippers engage in manipulations regarding the appropriate return on equity, cost of debt, and capital structure for SFPP; overstate SFPP's revenues; and understate SFPP's expenses – all designed to support Indicated Shippers' predetermined but unsupported position that SFPP rates, which have been changed only once since they were last approved in 1992 to reflect documented increases in power costs, have somehow been transformed into wildly excessive rates.

Indicated Shippers have presented no evidence whatsoever to rebut SFPP's showing that its electricity surcharge is entirely justified by increases in power costs reasonably forecasted to occur. Instead, Indicated Shippers rely solely on the patently false argument that because the electricity surcharge implemented via Advice Letter No. 14 was premised on SFPP's status as a bundled utility customer SFPP avoided the power cost increases experienced by all other California consumers by switching to Direct Access service after it filed Advice Letter No. 14. Indicated Shippers do not, however, dispute the fact that SFPP's power costs, as forecasted in Advice Letter No. 14, did increase dramatically whether incurred as a bundled utility customer or as a Direct Access customer. Further, Indicated Shippers ignore state legislation and a string of Commission decisions enacted in the aftermath of California's energy crisis which imposed additional charges on Direct Access customers to ensure that such customers made the same contribution to utility recovery of supply procurement costs as the utility's bundled customers.

Given that the entirety of SFPP's electricity surcharge is factually and legally justifiable, the import of Indicated Shippers' contention that SFPP is far overearning its cost of service is essentially reduced to the irrational claim that SFPP's 1992 rates, as approved by the Commission as reasonable, while neither changed nor adjusted for inflation, have now become excessive by the astounding amount of $32.6 million. In evaluating the merits of Indicated Shippers' efforts to effectively (and unlawfully) reduce SFPP's 1992 rates by $32.6 million, the Commission should remain mindful of the defined scope of A. 03-02-027.

The issue to be resolved by the subject application has been specifically and expressly defined by the Administrative Law Judge's Ruling Setting Procedural Schedule and Clarifying Scoping Memo ("ALJ Scoping Memo") dated June 26, 2003 which reads, in pertinent part, as follows:

> **The scope of the present proceeding, A. 03-02-027, will be limited to whether SFPP should be permitted an electricity surcharge.**[3] The Commission will determine whether SFPP's rates are reasonable based on Test Year 2003 revenue requirement, and that revenue requirement will be

[3] Resolution O-0043 issued by the Commission on October 24, 2002, conditionally approved SFPP's request to increase its rates (via surcharge) by approximately $5.77 million on an annual basis to reflect anticipated increases in power costs. It further directed SFPP to submit a 2003 TY cost of service showing by February 21, 2003. Under the Commission's traditional approach to test year ratemaking, utility filings are made 12-to-18 months prior to the beginning of the test year period, with the intention that the rates approved by the Commission will become effective on the first day of the test year period. While O-0043 directed a 2003 TY filing to be made in February, 2003 (perhaps in an inadvertent departure from routine practice), application of normal Commission procedure would have dictated that SFPP file a 2004 TY showing in February, 2003, justifying rates to go in to effect as of January 1, 2004.

> applied to see if the requested electric surcharge rate increase was justified from the date of its imposition by Resolution O-0043 until the adoption of test year 2003 rates. This determination will be made on the basis of SFPP's cost-of-service showing. (emphasis added).

A. 03-02-027 is intended to address two issues: (1) whether and to what extent, if any, the $5.77 million in annual surcharges collected by SFPP, starting from the date of issuance of Resolution O-0043 (October 24, 2002) is unjustified and should be refunded; and (2) what is an appropriate cost-of-service baseline to be used as a means of evaluating the reasonableness of SFPP's rates on a forward-going basis, commencing January 1, 2004 and extending through the TY forecast period. This case is not, as Indicated Shippers implicitly contend, about whether SFPP's 1992 rates are overearning by $32.6 million. Rather, it is about (i) SFPP's entitlement to retain all electricity surcharges collected since October 24, 2002 and (ii) undertaking the first general rate case review for SFPP since 1992 for the purpose of establishing a fair and proper forward-looking forecast of the cost of service to be used as a measure of the reasonableness of SFPP's rates as of January 1, 2004 and beyond.[4]

As set forth more fully below, SFPP submits that the record evidence quite clearly establishes that (i) SFPP is entitled to retain all electricity surcharges collected since October 24, 2002 because such recovery is justified both by the reasonableness of the forecasted power cost increase upon which SFPP relied and by a cost-of-service analysis demonstrating that SFPP is not overearning; and (2) SFPP's rates, as of January 1, 2004 and beyond, are reasonable based upon a forward-looking, 2003 TY forecast of SFPP's cost of service.

---

[4] While SFPP will herein separately address the issues relating to the reasonableness of the Watson Station Volume Deficiency Charge and the Sepulveda Line rate, SFPP submits that if the Commission determines that SFPP's systemwide rates are reasonable based upon Commission analysis of a forward-looking 2003 TY forecast of California jurisdictional cost of service, then, by definition, rates charged for individual components of SFPP service, such as the Watson Station Volume Deficiency Charge and the rate for the Sepulveda Line, cannot be unreasonable as long as SFPP's overall rates remain reasonable.

II. SUMMARY OF SFFP'S POSITIONS AND RECOMMENDATIONS

The subject brief addresses three, distinct questions: (1) whether SFPP is entitled to retain all of the electricity surcharges it has collected since October 24, 2002; (2) whether SFPP's forward-going rates are reasonable based upon a 2003 TY cost-of-service analysis; and (3) whether the rates associated with the Watson Station Volume Deficiency Charge and the Sepulveda line are reasonable. A summary of SFPP's positions and recommendations with respect to each of these questions is set forth as follows:

A. Electricity Surcharge Issues:

- The entire electric surcharge rate increase collected since October 24, 2002 is justified whether it is evaluated based upon the reasonableness of Advice Letter No. 14's forecast of anticipated power cost increases or based upon a 2003 TY analysis of SFPP's overall, systemwide cost of service.
- The evidence of record shows that Advice Letter No. 14's forecast of expected power cost increases was reasonable.
- Indicated Shippers present no evidence rebutting SFPP's showing that its forecast of power cost increases was reasonable.
- Indicated Shippers' challenge to the legitimacy of SFPP's forecasted increase in electricity costs is premised solely on the demonstrably false theory that SFPP's transition from status as bundled utility customer to a Direct Access customer allowed SFPP to avoid the increase in power costs anticipated by Advice Letter No. 14.
- Indicated Shippers fail to recognize that Direct Access customers did incur increases in power costs associated with California's energy crisis similar in scope, if not ultimately identical, to those forecasted by Advice Letter No. 14.
- Indicated Shippers further fail to recognize the impact of Commission decisions (i) requiring Direct Access customers to bear the same responsibility for utility procurement costs as bundled customers, thereby assuring that SFPP incurred the same cost for power as it would have if it had remained a bundled utility customer and (ii) entirely validating the reasonableness of Advice Letter No. 14's forecasted electricity cost increases.
- SFPP's 2003 TY cost-of-service showing, which includes its electricity surcharge revenues, clearly demonstrates that SFPP is not overearning and is therefore

entitled to retain all of its electricity surcharges collected since October 24, 2002.

B. <u>2003 TY Cost of Service Issues</u>:

- As expressly explained by the California Supreme Court, a test period is intended to consider utility operations during the future months or years for which the Commission proposes to fix rates and, in order to accurately represent future conditions as nearly as possible, test period results are adjusted to allow for known or reasonably anticipated changes in utility revenues, expenses, or other conditions.

- Costs associated with SFPP's $88 million North Line Expansion Project, whether incurred in 2003 or 2004 when the project was scheduled for completion, were either known or reasonably anticipated and are, as a matter of law and policy, properly includable in development of SFPP's 2003 TY cost of service.

- Indicated Shippers' position that only costs actually incurred in 2003 are eligible for inclusion in SFPP's 2003 TY cost of service is flatly wrong as a matter of law and policy.

- There is no legal, factual, or policy basis to deny SFPP a full income tax allowance. No regulatory body, state or federal, has adopted a tax allowance policy based upon Indicated Shippers' radical theory premised on the simplistic notion that SFPP should not be afforded any income tax allowance merely because the partnership itself does not pay taxes as a pass through entity, while ignoring the fact that taxes are incurred and paid by individual partners themselves.

- Existing Commission policy regarding allowances for test-year income tax expense makes no distinction based upon the form of organization of the utility nor does it adjust the allowance to reflect income taxes actually paid by the utility.

- Even if the Commission were unaccountably inclined to create a new, punitive tax allowance policy applicable only to SFPP, SFPP submits, on legal as well as equitable grounds, that any such change in policy can only be given prospective, ratemaking effect and cannot be lawfully applied to any SFPP rates collected prior to January 1, 2004, including electricity surcharges and rates related to the Watson Station and Sepulveda facilities.

- As a matter of fundamental fairness, SFPP should not be singled out among all of the state's regulated utilities and subjected to a unique ratemaking policy based simply on its form of organization.

- SFPP's assumed rate of return for TY 2003, including a proposed cost of equity of 15.86%, a proposed cost of debt of 7.08%, and a capital structure consisting of 60% equity and 40% debt, is reasonable.

- SFPP's Allocation of TY 2003 General and Administrative ("G&A") expenses incurred by Kinder Morgan Energy Partners, L.P. ("KMEP") on behalf of SFPP is reasonable and consistent with applicable federal requirements.

- SFPP's 2003 TY estimate for fuel and power expense is reasonable.

- SFPP's adjustment of TY 2003 expenses related to oil losses and shortages is reasonable.

- SFPP's adjustment of its TY 2003 cost of service to reflect expenses associated with eventual dismantlement, removal, and restoration of its pipeline system is reasonable.

- SFPP's TY 2003 estimate of throughput volumes is reasonable.

- The reasonableness of SFPP's rates on a cost-of-service basis is further validated by consideration of the facts that SFPP is not a monopoly; its customers are large, sophisticated oil companies with economically viable alternatives to a significant portion of SFPP's services; its rates compare favorably with other pipeline rates; and SFPP's transportation rates have a *de minimis* impact upon the price of gasoline charged to consumers at the pump by the oil companies.

C. <u>Watson Station Volume Deficiency Charge and Sepulveda Line Issues</u>:

- The Indicated Shippers effectively concede that Commission resolution of the questions presented by A. 03-02-027 will render moot the contested issues currently pending in C. 97-04-025 and C. 00-04-013, including issues relating to the reasonableness of the Watson Station Volume Deficiency Charge and the intrastate rate for service on the Sepulveda line.

- There is no consumer interest to justify cost of service regulation of rates charged for specific services involving SFPP's Watson Station and Sepulveda facilities.

- Given the economically viable alternatives available to SFPP's large and sophisticated oil company shippers, the reasonableness of rates charged for Watson Station and Sepulveda services up to and until December 31, 2003 should be evaluated, consistent with existing Commission pipeline ratemaking policy, based upon market, rather than cost of service, factors as well as in the context of SFPP's overall cost of service.

- Because the rates for Watson Station and Sepulveda are subject to market discipline in light of alternatives available for shippers to avoid use of SFPP's facilities, existing Commission policy regarding appropriate ratemaking treatment for pipeline corporations like SFPP, which includes consideration of market conditions, fully supports a finding that all related rates for the period through December 31, 2003 were reasonable.

- With respect to the reasonableness of specific rates for Watson Station and Sepulveda for the period covered by the 2003 TY cost of service analysis, i.e. January 1, 2004 forward, the Commission will be evaluating the reasonableness of SFPP's rates on a systemwide basis and will not examine whether the rate for each of many, individual pipeline movements or services is itself reasonable on a cost-of-service basis. Because SFPP's systemwide rates are reasonable based upon proper analysis of SFPP's 2003 TY cost of service (which includes revenues and expenses associated with the Watson Station/Sepulveda services), the rates charged for individual components of SFPP service, such as the Watson Station Volume Deficiency Charge and the rate for the Sepulveda line are, as a matter of fact and law, reasonable to the extent SFPP's overall rates remain reasonable.

- For all relevant time periods (up and to December, 2004), the record reflects that the 3.2¢/bbl. Watson Station Volume Deficiency Charge and the 5¢/bbl. rate for the Sepulveda line were reasonable.

III. ARGUMENT

A. SFPP Is Entitled to Retain All Electricity Surcharges That It Has Collected Since October 24, 2002.

SFPP recognizes that the ALJ Scoping Memo expressly states that the 2003 TY revenue requirement adopted by the Commission in this proceeding will be applied to determine whether SFPP is entitled to retain electricity surcharges collected since October 24, 2002 and is confident that its retention of all such collected electricity surcharges will be fully justified when evaluated in the context of 2003 TY cost of service analysis. Nevertheless, SFPP suggests that there is an analytical inconsistency in relying upon a forward-looking TY analysis, which is designed to set the revenue requirement for the period from January 1, 2004 forward, as the basis for evaluating the reasonableness of rates collected during a prior, past period (i.e. October 24, 2002 to January 1, 2004). Typically, when the Commission has engaged in after-the-fact reasonableness review of a utility's rates, as is the case with the electricity surcharge collected since October 24, 2002, its consideration of the justness and reasonableness of the past rate increase is itself founded on a determination of the reasonableness of the utility's assumed basis for raising its rates, judged in the context of the facts available and reasonably known to the utility at the time of its rate filing. It is with the Commission's traditional reasonanleness review standard in mind that SFPP will demonstrate that it is entitled to retain all electricity surcharges that it has collected, whether the validity of such charges is considered under the Commission's traditional standard for after-the-fact reasonableness review or under the ALJ Scoping Memo standard of analyzing the electricity surcharges in relation to a 2003 TY cost of service.

Based upon the evidence of record in A. 03-02-027, the Commission can determine SFPP's reasonable cost-of-service based upon a 2003 Test Year analysis extending through December, 2004 when SFPP, via A. 04-11-017, increased its rates by $9 million above the level of rates at issue in A. 03-02-027. The filing of A. 04-11-017 constitutes a material change in factual circumstances and requires development of its own, independent record in order for the Commission to evaluate the reasonableness of SFPP's rates for the period from December, 2004 forward.

Once the Commission addresses the issues raised by A. 03-02-027, including determination of the reasonable level of SFPP's cost of service through December, 2004, the Commission will necessarily be in a position to determine what portion, if any, of the approximately $6 million in annual electric surcharges collected since October, 2002 (the date of issuance of Resolution O-0043) is unjustified and should be refunded. If the Commission determines that SFPP was not collecting revenues in excess of its reasonable 2003 TY cost of service during the period from October, 2002 to December, 2004, as SFPP believes to be the case, then there will be no refund of any portion of electricity surcharge revenues collected. If the Commission were to determine that SFPP overcollected its 2003 TY cost of service by $6 million or less, SFPP would be required to refund the appropriate portion of $6 million in annual electricity surcharges collected between October, 2002 and December, 2004.

For reasons set forth below, SFPP submits that the Commission must conclude that SFPP was entirely justified in collecting approximately $12 million of electricity surcharges between October, 2002 and December, 2004 and that no portion of any such collected revenues need be refunded to SFPP's shippers.

1. Advice Letter No. 14's Forecast of a $5.77 Million Annual Increase in Power Costs Is Reasonable, and SFPP's Switch from Bundled Utility Service to Direct Access Service Has No Impact Upon the Reasonableness of the Estimated Increase in Power Costs.

SFPP's first rate increase request in twelve years, Advice Letter No. 14, was filed on May 10, 2001 in anticipation of an extraordinary increase in electricity costs occasioned by California's well-documented energy crisis. Advice Letter No. 14 sought about $500,000 per month to offset anticipated increases in the cost of bundled electric service. The evidence of record, as described more fully below, shows that SFPP's power costs, whether incurred as a bundled customer or a Direct Access customer, did increase by amounts entirely consistent with level of power cost increases forecasted by Advice Letter No. 14. Indicated Shippers, on the other hand, present no evidence suggesting that Advice Letter No. 14's forecast of $500,000 per month in increased power costs is unreasonable, nor any evidence to rebut SFPP's showing validating the anticipated increase in its power costs.

Instead, Indicated Shippers' challenge to the legitimacy of SFPP's electricity surcharge is premised on the demonstrably false theory that SFPP's transition from status as bundled utility customer to a Direct Access customer allowed SFPP to avoid the increase in power costs that was anticipated by Advice Letter No. 14.

From June, 2001 through the last quarter of 2001, SFPP did incur the increase in bundled electric utility rates as described in Advice Letter 14. The fact that SFPP switched to Direct Access service in late 2001, thereby avoiding some but not all of the bundled customer surcharges, does not mean that SFPP as a Direct Access customer avoided the $500,000/month increase in power costs that were anticipated by Advice Letter 14. Direct Access customers were not immunized from the substantial increases in electricity experienced by all Californians as result of the energy crisis. In fact, it can be demonstrated that power cost increases experienced by SFPP, despite its status as a Direct Access customer in 2002, directly correspond to power cost increases of $500,000/month that were forecasted by SFPP in Advice Letter No. 14.

Advice Letter No. 14's forecasted electricity cost increase of $500,000/month was based on reasonable assumptions made by SFPP at the time of filing. While there was subsequently a change in the underlying assumption regarding SFPP's customer status, workpapers submitted by SFPP in A. 03-02-027 support the continuing validity of Advice Letter 14's forecasted increase of $500,000 per month in power costs. In support of Advice Letter No. 14, SFPP provided its estimate that electric costs associated with SFPP total carrier operations (interstate and intrastate) would increase from $19 million in 2000 to $30.8 million for the year beginning June, 2002, i.e. an anticipated increase in jurisdictional power costs of about $11.8 million.[5] Workpapers submitted in A. 03-02-027, incorporating data from SFPP's FERC Form 6 filings for 2000 and 2002, reflect a $9.1 million increase in power costs for the period 2000-2002 (from $22.2 million to $31.3 million) as well as SFPP's estimate that electric costs for California carrier operations would increase by $3.4 million in 2003 over comparable

[5] Resolution O-0043, mimeo. at 7.

2002 costs.[6] This increase in total carrier power costs of $12.5 million (i.e. the 2000-to-2002 actual increases of $9.1 plus the estimated 2003 increase of $3.4 million) corresponds reasonably well with the estimated $11.8 million increase in carrier power costs which, in turn, served as the basis for Advice Letter No. 14's request for a $5.77 million annual electricity surcharge.

While moving from bundled service to direct access service in the fall of 2001 was undoubtedly the prudent and responsible business decision for SFPP to make, it did not reduce SFPP's power costs back to pre-energy crisis levels. Had SFPP remained a bundled service customer, this increase would have been significantly greater (at least up until the adoption of the 2.7 cent Direct Access surcharge in 2002), as evidenced in the following analysis of SFPP's two largest intrastate energy using locations:[7]

Location	**Pre-Energy Crisis December 2000**	**Energy Crisis—Bundled Service July 2001**	**Energy Crisis—Direct Access December 2001**	**Energy Crisis—Direct Access July 2003**	**Energy Crisis—Direct Access December 2003**
<u>Concord Station</u>					
○ $'s / kWh	$0.028	$0.093	$0.060	$0.072	$0.089
○ % Increase from Pre-Energy Crisis	na	237%	119%	160%	221%
<u>Watson Station</u>					
○ $'s / kWh	$0.038	$0.108	$0.057	$0.079	$0.090
○ % Increase from Pre-Energy Crisis	na	187%	52%	110%	140%

This analysis demonstrates that SFPP experienced increased power costs due to the California energy crisis, regardless of its customer status (bundled service or direct access).

---

[6] Ex. 105A; Turner at 13.

[7] All data is taken from SFPP power invoices supplied to Indicated Shippers.

The conservative analysis used by SFPP to justify its request for a tariff surcharge, in Advice Letter No. 14, predicted an increase in power costs of approximately 59 percent. As can be seen in the table above, this 59 percent power cost prediction was reasonable irrespective of SFPP's status as a bundled service customer or a direct access customer.

Finally, and perhaps most significantly, Indicated Shippers ignore the impact of legislation and related Commission decisions resulting from California's energy crisis that required Direct Access customers to bear the same responsibility for utility procurement costs as bundled customers, thereby assuring that SFPP ultimately incurred the same cost for power as it would have if it had remained a bundled utility customer.

AB 117, establishing Pub. Util. Code §366.2, subd.(d)(1), provides as follows:

> It is the intent of the Legislature that each retail end-use customer that has purchased power from an electrical corporation on or after February 1, 2001, should bear a fair share of the [DWR's] electricity purchase costs, as well as electricity purchase contract obligations incurred…that are recoverable from electrical corporation customers in commission-approved rates. It is further the intent of the Legislature to prevent any shifting of recoverable costs between customers.[8]

The legislature first passed AB 1X during its first Extraordinary Session directing the Commission to suspend Direct Access in Decision 01-09-060, followed by enactment of AB 117 which assured that Direct Access customers would pay their fair share of costs associated with California's energy crisis. The Commission initiated implementation of the legislatively mandated cost-sharing mechanism in Decision 02-03-055, in which the Commission determined that charges must be imposed on Direct Access customers sufficient to ensure that bundled service customers do not bear higher costs due to the migration of a significant number of customers from bundled to DA service between July 1 and September 20, 2001. It was Decision

[8] D. 03-04-030, mimeo. at 37.

02-11-022 in which the Commission, responding directly to the mandate of AB 117, created the Direct Access Cost Responsibility Surcharge ("DA CRS") for all of the IOUs. The surcharge made up for costs comprised of (1) costs incurred by the California Department of Water Resources (DWR) on behalf of customers in the service territories of the three major utilities, and (2) costs incurred by each of the utilities through their own resources and contracts.

Thus, through a series of implementing decisions, the Commission authorized the serving utilities to retroactively bill their Direct Access customers in amounts equal to the supply procurement costs that the Direct Access customer otherwise avoided by switching from bundled utility service to Direct Access service. Direct Access customers, including SFPP, were required to remit to the utilities essentially the same total amount of charges that they would have been billed if they had remained bundled utility customer.[9]

Consequently, in the end, SFPP experienced the same increased costs for supply and distribution of power that were imposed upon bundled utility customers - just as anticipated in Advice Letter No. 14.

2. SFPP's 2003 TY Cost-of-Service Showing, Which Includes Its Electricity Surcharge Revenues, Clearly Demonstrates that SFPP Is Not Overearning and Is Therefore Entitled to Retain All of Its Electricity Surcharges Collected Since October 24, 2002.

As set forth in detail in Section III.B below, SFPP's 2003 TY cost-of-service showing, including all revenues related to the electricity surcharge, demonstrates that SFPP's test period cost of service exceeds its test period revenue by approximately $14.6 million.[10] Evidence that SFPP is underearning its cost of service is further proof that SFPP's surcharge for

[9] See e.g. D. 02-04-067, mimeo. at 5.
[10] Exhibit 104A; Turner at 18.

increased electric energy costs as conditionally approved by Resolution O-0043 issued October 24, 2002 is indeed justified and therefore reasonable.[11]

B. Based Upon A 2003 Test Year Analysis of SFPP's Cost of Service, It Is Clear That SFPP's Rates For the Period From January 1, 2004 to December, 2004 Including Rates Associated with the Electricity Surcharge, Watson Station, and the Sepulveda Line, Are Reasonable.

SFPP does question whether a forward-looking 2003 TY analysis, which necessarily embraces known or reasonably anticipated future costs, has a rational relationship to consideration of the reasonableness of rates collected during a prior, past period. Nevertheless, Indicated Shippers primarily base their claim for refund of electricity surcharges collected from October, 2002 upon a faulty cost-of-service analysis of appropriate rate levels for SFPP as of January 1, 2004. Then, in a further flight from reality, Indicated Shippers contest the reasonableness of SFPP's electric surcharge on overall cost-of-service grounds by advancing the astounding argument that SFPP – with its one rate increase since 1992 - is over-recovering its cost of service by $32.6 million or almost half (48 percent) of the artificially deflated 2003 Test Year cost of service concocted by the Indicated Shippers.[12]

To reach such a patently absurd and counter-intuitive result, Indicated Shippers raise a laundry list of challenges to SFPP's 2003 TY cost-of-service showing, including the following, recommended adjustments: (1) disallowance of the North Line Expansion Project as a rate base addition; (2) elimination of any income tax allowance; (3) reduction of SFPP's TY 2003 rate of return; (4) adjustment of the methodology and related ratios for allocating TY 2003

---

[11] It is somewhat incongruous for the Commission to rely upon a 2003 TY cost-of-service analysis (filed in February, 2003) which is designed to establish the reasonable level of SFPP's rates on a forward-going basis, i.e. as of January 1, 2004, to evaluate the reasonableness of electricity surcharges collected during the past period from October 24, 2002 to January 1, 2004. There simply is no cost-of-service showing in the record that reflects the period from October 24, 2002 to January 1, 2004.

[12] Ex. 200A; O'Loughlin at 3.

General and Administrative ("G&A") expenses incurred by KMEP on behalf of SFPP; (5) reduction of SFPP's test year estimate for Fuel and Power Expense; (6) reduction of recoverable expenses related to an adjustment to reflect higher average annual credit balances in SFPP'S Oil Losses & Shortage account; (7) elimination of any allowance for Dismantlement, Removal, and Restoration ("DR&R") expense; and (8) upward adjustment of SFPP's estimated test year throughput volumes.[13]

SFPP has estimated its TY 2003 cost of service to be $108,590,000, with revenues projected at $93,974,000, thereby demonstrating that it is under-recovering its cost of service by $14,616,000 at existing rate levels, including the electric surcharge.[14] Conversely, Indicated Shippers estimate SFPP's test year cost of service to be $68,331,000, while projecting $100,931,000 in revenues and thereby assert that SFPP is over-earning by $32,600,000.[15] The difference of $40,259,000 between SFPP's TY 2003 cost of service ($108,590,000) and Indicated Shippers' test year estimate ($68,331,000) derives from the above-referenced adjustments to SFPP's cost of service that Indicated Shippers have recommended.[16]

The potential reduction in SFPP's overall cost of service that is associated with each of the adjustments proposed by Indicated Shippers is reflected in the following table:[17]

---

[13] *Id.* at 5.

[14] Ex. 104A; Turner at Attachment A.

[15] Ex. 200A; O'Loughlin at 3.

[16] The difference of $6,957,000 between Indicated Shippers' test year revenue estimate ($100,931,000) and SFPP's test year revenue estimate ($93,974,000) is caused by differences between Indicated Shippers' and SFPP's estimates of TY 2003 throughput volumes. (See Ex. 200A; O'Loughlin at 3).

[17] Ex. 200A; O'Loughlin, Attachment B.

Impact of Indicated Shippers' Adjustments Upon SFPP's Cost of Service:[18]

No Income Tax Allowance	$ 9,846,000
Remove North Line Expansion Capital	$10,313,000
Debt Capital Structure of 55.94% (v. 40%)	$ 4,789,000
Nominal Equity ROR of 12.80% (v. 15.86%)	$ 4,589,000
Debt cost of 6.41% (v.6.66%)	$ 148,000

Impact of Indicated Shippers' Expense Adjustments:

Removal of DR&R Expense	$ 1,252,000
Reduction of Fuel & Power Expense	$ 2,876,000
Over/Shorts Expense	$ 610,000
Adjustment of Overhead Allocations -	
Mass Formula Adjustment to include all subs	$ 3,608,000
Remove PAA from Mass and K/N Formula	$ 2,227,000

As the above-referenced table reflects, the issues involving rate base treatment for the North Line Expansion and federal tax allowances are pivotal to determination of SFPP's Test Year 2003 cost of service. While each and every one of the myriad adjustments to SFPP's cost of service as proposed by Indicated Shippers will be shown below to be without justification, it is the arbitrariness of the Indicated Shippers' proposed treatment of the North Line Expansion and tax allowances that underscores the illegitimacy of their challenge to the reasonableness of SFPP's electric rate increase surcharge.

1. The North Line Expansion Is a Valid Test Year Cost-of Service Adjustment.

Given the Commission's stated intention to rely on Test Year 2003 results to resolve the subject application, it is important to understand the scope of the "test period" chosen by the Commission as the basis for its review of the reasonableness of SFPP's electric surcharge. As stated by the California Supreme Court:

[18] The amounts referenced below represent reductions in SFPP's recommended cost of service of $108,590,000 that would result from Commission adoption of each of the cost of service and expense adjustments recommended by Indicated Shippers.

The test period is chosen with the objective that it present as nearly as possible the operating conditions of the utility which are expected to obtain during the future months or years for which the commission proposes to fix rates. The test-period results are "adjusted" to allow for the effect of various known or reasonably anticipated changes in gross revenues, expenses or other conditions, which did not obtain throughout the test period but which are reasonably expected to prevail during the future period for which rates are to be fixed, so that the test-period results of operations as determined by the commission will be as nearly representative of future conditions as possible." *Pacific Telephone and Telegraph Company v. Public Utilities Commission*, (1965) 62 Cal.2d 634, at 645.

While 2003 is obviously the relevant "test period" for purposes of the subject application, it is equally clear that action potentially available to the Commission in this proceeding, i.e. the reduction or elimination of the electric surcharge rate increase, will affect rates to be charged by SFPP in 2004 and beyond.[19] For that reason alone, it is incumbent upon the Commission to give consideration to "the operating conditions of the utility which are expected to obtain during the future months or years" in which rates may be adjusted, certainly including 2004.

Furthermore, the Court expressly acknowledges the necessity of giving consideration and effect to "anticipated changes in gross revenues, expenses or other conditions, *which did not obtain throughout the test period* but which are reasonably expected to prevail during the future period" in which rates may be adjusted.[20] In evaluating SFPP's results of

---

[19] It is all the more obvious that 2004 costs are properly includable in the 2003 TY when consideration is given to the fact that if the Commission had followed its normal procedure, SFPP should have been directed to file a 2004 TY filing in February, 2003 rather than a 2003 TY filing. The Commission's normal practice would have avoided the anomaly of using forecasted 2003 TY costs as the basis for setting rates to become effective in 2004 and properly would have based 2004 rates on estimated 2004 cost of service.

[20] SFPP again notes that it has come to the Commission only one time since 1992 seeking to increase its rates. The fact that SFPP, unlike the major electric and gas utilities regulated by the Commission, is not subject to periodic rate review (i.e., a general rate review conducted every three years) further underscores the need for the Commission to extend the temporal horizon or "test period" applicable to the Commission's review of SFPP's rates.

operations for purposes of testing the reasonableness of SFPP's power cost surcharge, the Commission, per the Court's instruction, is required to consider not only Test Year 2003 information but also changes in SFPP's revenues, expenses, or other conditions which are not present during Test Year 2003 yet are reasonably expected to occur during the period in which rates may be adjusted, i.e. certainly including 2004 and perhaps beyond. This is exactly the case presented by SFPP's North Line Expansion Project, which involves incurrence of known costs in 2003 as well as reasonably expected costs in 2004.

SFPP undertook a project to expand its North Line between Concord and Sacramento.[21] This expansion consisted of approximately 70 miles of 20-inch pipeline as well as substantial pump station work at Concord. Upon completion of the project, anticipated in the fall of 2004, SFPP's existing 14-inch line from Concord to Sacramento, as well as its Elmira pump station, was to be removed from service. The project was estimated to cost \$88 million, of which \$62.6 million is associated with California jurisdictional facilities and services.[22]

The test period for the subject proceeding is Year 2003.[23] As defined in *Pacific Telephone and Telegraph Company v. Public Utilities Commission*, (1965) 62 Cal.2d 634, test period results properly reflect costs and conditions expected to occur during the twelve months of 2003 as well as reasonably anticipated changes in gross revenues, expenses or other

---

[21] While the North Line Expansion Project was completed by and commenced service in December, 2004, the arguments set forth herein reflect the record in A. 03-02-027 as it existed when the matter was submitted in February, 2004.

[22] Ex. 100A; Morgan at 2.

[23] While Indicated Shippers' witness cites references in Resolution O-0043 to cost-of-service data for years 2001, 2002, and 2003 to support an implication that year 2001 or year 2002 data is a basis for testing the reasonableness of SFPP's electric surcharge revenue collections, the ALJ Scoping Memo governs and makes it explicit that Year 2003 is the test period for evaluating the reasonableness of SFPP's rates. (See Ex. 200A; O'Loughlin at 10).

conditions, which do not necessarily obtain throughout the twelve months of the test period but which are reasonably expected to prevail during the future period.

While some portion of the $88 million in costs associated with SFPP's North Line Expansion was not to be incurred in calendar year 2003, it was reasonably anticipated that all of such costs would be incurred by the end of 2004.[24] As such, the law is quite clear that SFPP's TY 2003 rate base should properly reflect North Line Expansion costs in their entirety.

As further justification for inclusion of North Line Expansion costs in SFPP's test period results of operations, SFPP notes that development of a representative test year rate base is particularly important given the extreme variability (or so-called "lumpiness") of capital investment that characterizes the pipeline industry. Pipelines by their nature require large initial investments, while subsequent capacity expansions require much smaller investments.[25]

Given that SFPP does not file for periodic general rate case review, that SFPP has not filed an application for a general rate increase with the Commission since 1991, and that there is no schedule or Commission requirement for filing a future general rate case, development of a test year reflecting costs that are reasonably expected to prevail during the future period is of critical importance. Excluding the known and measurable North Line expansion costs would result in a test year cost of service that would not reflect SFPP's future operations.

---

[24] The evidence of record regarding the project schedule and estimated budget for the North Line Expansion was uncontroverted. The witness for Indicated Shippers presented no facts contesting the validity of either the forecasted project completion date or the project's estimated cost of $88 million. Rather, his basis for characterizing the North Line Expansion as "speculative" involved nothing more than the fact that project completion was, at the time of his testimony, some twelve months' in the future. (See Tr. Vol. 4; O'Loughlin at 470-471).

[25] Ex. 105A; Turner at 4.

Nevertheless, Indicated Shippers contest the inclusion of a significant portion of the North Line Expansion costs in SFPP's test period rate base. Their rationale is, at best, suspect and relies upon arbitrary limitation of the test period to the twelve calendar months of 2003. Indicated Shippers take the position that only projects with planned in-service dates during the twelve months of the 2003 test period can properly be reflected as a test year capital addition provided that there is a "high degree of confidence" that the projects are going to be completed in 2003.[26] In other words, it is Indicated Shippers' stated position that only costs that are incurred or almost certainly will be incurred <u>during calendar year 2003</u> can be included in SFPP's Test Year 2003 cost-of-service results.[27]

The following colloquy between counsel and the witness for Indicated Shippers' makes clear the extremity of Indicated Shippers' standard for evaluating costs properly includable in the test period:

> Q. If it can be shown that the cost associated with the North Line Expansion and its in-service date are not speculative, would you advocate including its costs in SFPP's test year rate base?
>
> A. No.
>
> Q. What degree of certainty about a future project is necessary to include it as a valid rate base addition?
>
> A. The issue goes beyond certainty. It comes to time period. It comes to time period. If I'm looking at rates for an application that is filed back in May 2001 saying that rates were insufficient, and so I'm looking at rates and cost of service for 2001, 2002, and test year 2003,costs that I anticipate incurring in 2004 or 2005 and beyond don't fit regardless of how well known they are.
>
> Q. We're sitting here today with a 2003 test year period before us, and I'm

[26] Ex. 200A; O'Loughlin at 10.

[27] This rigid position, reflecting an artificially created temporal limitation on includable costs, appears designed to avoid the import of the established test year ratemaking principle of including "known or reasonably anticipated" costs.

> asking you to assume with 100 percent certainty the North Line expansion will be in service in November 2004, and it will have cost $88 million Is it your testimony it should not be included for test year ratemaking?
>
> A. It should not be included for test year ratemaking for 2003.[28]

The above-referenced answers by the witness for Indicated Shippers betray a fundamental misapprehension of applicable law as well as the scope of this proceeding. His view that test period results are limited to consideration of costs and conditions that literally occur within the twelve-month, calendar period is expressly refuted by the California Supreme Court's explicit recognition that test period results include not only costs incurred during the defined test period but also those costs reasonably anticipated to occur in future months beyond those of the test period. Furthermore, the witness directly contradicts the ALJ's Scoping Memo which has expressly established a forward-looking test year (i.e. 2003) as the measure of the reasonableness of SFPP's rates by basing his evaluation, at least in part, on a backward review of historical or recorded information dating from 2001.

None of the remaining arguments raised by Indicated Shippers justifies exclusion of any North Line Expansion additions to SFPP's Test year 2003 rate base. The claim that SFPP did not treat test year adjustments to rate base consistently because it allegedly included "two years of capital additions while including only one year of depreciation"[29] is a mischaracterization of SFPP's development of its test year rate base. Specifically, Resolution O-0043 required the development of an "estimated year 2003." To comply with this requirement, SFPP made three adjustments to SFPP's 2002 rate base to develop a 2003 test year

---

[28] Tr. Vol. 4; O'Loughlin at 472-473.

[29] Ex. 200A; O'Loughlin at 9.

rate base: (1) including 2003 budgeted capital projects, (2) subtracting property retirements scheduled to take place in 2003, and (3) reflecting an additional year of plant depreciation.[30]

Included in SFPP's 2003 capital budget are expenditures for the North Line expansion project.[31] The fact that the North Line expansion project will be completed in 2004 does not render this event unsuitable for test year purposes as Indicated Shippers' claim. Contrary to the Indicated Shippers' suggestion, the fact that such costs are not knowable to a degree of absolute certainty – a requirement that would necessarily only allow actual, recorded costs to be included in any test year cost-of-service analysis – does not mean that the involved costs are either not known or reasonably anticipated.

Indicated Shippers are apparently willing to concede that it is proper to include budgeted amounts for 2003 in the test year 2003 cost of service analysis if there is a high degree of confidence that the capital project is going to be completed at budgeted amounts. Logically, Indicated Shippers should likewise be prepared to concede that budgeted amounts for 2004 are properly included in test year 2003 analysis of SFPP's cost-of-service if there is a high degree of confidence that the projects will be completed and on budget. In that context, there was no dispute whether the North Line expansion would indeed be completed in 2004 and at its budgeted amount of $88 million. Indicated Shippers make no claim to the contrary, much less provide any basis for disputing SFPP's reasonable expectations about either project completion or its ultimate cost.

2. <u>There Is No Legal, Factual, or Policy Basis to Deny SFPP a Full Income Tax Allowance.</u>

At the outset, it must be noted that the federal income tax allowance issue is only

[30] Ex. 104A; Turner at 9.
[31] *Id.* at 5.

relevant in the context of the Commission's determination of a TY 2003 revenue requirement for purposes of establishing the reasonableness of forward-going rates for the period January 1, 2004 and beyond. For various legal reasons, the Commission is barred from adopting a new tax allowance policy for SFPP and applying the policy retroactively as part of any review of the reasonableness of electricity surcharges and rates related to SFPP's Watson Station and Sepulveda facilities that were collected prior to January 1, 2004. As such, SFPP's arguments regarding income tax treatment allowance will primarily focus on reasons why the Commission should maintain a policy of affording SFPP a full income tax allowance in developing the underlying cost of service applicable to SFPP's rates as of January 1, 2004 and beyond.

Indicated Shippers would reduce their estimate of SFPP's Test Year 2003 cost of service by $14.6 million by totally eliminating an income tax allowance.[32] The rationale supporting the Indicated Shippers' radical and unprecedented ratemaking treatment is the simple fact that SFPP, which is organized as a partnership, does not itself pay taxes; rather, it is the individual partners who comprise the partnership that face actual or potential tax liability with respect to distributions received from the partnership.[33] The witness for Indicated Shippers admitted that he could not cite any regulatory body, state or federal, that has adopted a tax allowance policy that is consistent with his recommendation that no tax allowance be included in

---

[32] If SFPP were to be denied any income tax allowance, the effect of such a disallowance upon SFPP's cost of service, given appropriate weighting of rate base adjustments, would be a reduction in SFPP's COS of $9,846,000.

[33] The witness for Indicated Shippers acknowledged that his recommendation turns solely on SFPP's form of organization, i.e. its legal status as a partnership rather than a corporation. He admitted that if SFPP were formed as a corporation, rather than a partnership, SFPP would be entitled to a tax allowance <u>even if it paid no taxes</u>. He next demonstrated his unfamiliarity with existing Commission tax policy by incorrectly suggesting that the Commission considers the amount of taxes actually paid by a utility in establishing tax allowances for ratemaking purposes. (<u>See</u> Tr. Vol. 4; O'Loughlin at 464-465, ln. 8-28 and 1-11).

SFPP's 2003 TY cost of service.[34] He further acknowledged that he had no familiarity with or understanding of the Commission's existing policy regarding tax allowances for corporations that operate as a public utility in the State of California.[35]

In fact, existing Commission policy regarding allowances for test-year income tax expense makes no distinction based upon the form of organization of the utility nor does it adjust the allowance to reflect income taxes actually paid by the utility:

> It is the practice of the Commission, in calculating the test-year income tax expense, to assume a separate return basis considering solely utility operations. By making this assumption the Commission presumes that the utility will pay the income taxes generated by the adopted rates. However, because of a utility's affiliated or nonutility operations, its actual income tax liability will be determined as one member of a consolidated tax return. <u>Thus, income taxes collected through authorized rates may not actually be paid, but may be used to offset tax losses of other non-utility and affiliated members of the consolidated return.</u>[36]

According to Commission policy, a regulated utility, like SFPP, is allowed an income tax allowance at the rates applicable to corporations, based on the authorized return on equity. In C. 97-04-025 also involving SFPP, the Commission did indicate an intention to <u>review</u> whether partnerships should be afforded <u>different</u> tax allowance treatment from that applied to corporations, specifically anticipating consideration of the so-called *Lakehead* approach endorsed by the FERC which, before its abrogation by a federal court of appeals, looked to the tax situations of the income attributable to the owners of a limited partnership rather than uniformly imputing a tax allowance at the corporate rate.[37]

---

[34] Tr. Vol. 4; O'Loughlin at 462, ln. 3-10.
[35] Tr. Vol. 4; O'Loughlin at 465-466, ln. 21-28 and 1-9.
[36] *Income Tax Expenses for Rulemaking Purposes* (1984) 15 CPUC2d 42, at 49.
[37] CPUC Decision 99-06-093, 1999 Cal. PUC LEXIS 442, *4-5.

Subsequent action by a federal court of appeals repudiated the *Lakehead* approach and caused FERC to abandon its *Lakehead* policy, suggesting, at a minimum, that this Commission need not give the *Lakehead* approach any more consideration. The Commission's stated intention to review the now-discredited *Lakehead* tax allowance policy indicated, at most, a willingness to consider an approach that could lead to a change in the calculation of the amount of tax allowances to which SFPP might be entitled as a limited partnership. It certainly did not evidence any intention to examine the question of whether SFPP should be denied any tax allowance at all, much less provide required notice of any such an intention. With the disappearance of *Lakehead* as the potential alternative for revising (not eliminating) tax allowance treatment for partnerships like SFPP, the Commission need not and should not give any consideration to the Indicated Shippers' proposal to create a new, unique policy that calls for complete elimination of any tax allowance treatment for public utilities organized as limited partnerships.

While the rehearing order in C. 97-04-025 states that the Commission has no established policy regarding the tax allowance for a utility that is organized as a limited partnership,[38] it is further a matter of record that D. 92-12-085, issued in response to SFPP's 1991 application for a rate increase, reflects that SFPP was organized as a partnership at the time of the decision and that the rates approved by the Commission included a full allowance for federal income tax expenses, based on rates applicable to a corporation and the rate of return authorized for SFPP. Irrespective of the fact that the Commission has not enunciated a specific tax allowance policy for limited partnerships, any determination to provide SFPP with other than

[38] D. 99-06-093, mimeo. at 9.

a full tax allowance would be a change in the existing tax treatment policy actually applied by the Commission to SFPP.

With respect to Commission consideration of a prospective policy change that would deny public utility partnerships any tax allowance for purposes of establishing rates on a forward-going basis, Indicated Shippers cannot point to any legal or regulatory precedent to support their view that SFPP should not be entitled to a federal income tax allowance. The FERC has recently addressed the issue of the appropriate tax allowance treatment for pipeline companies organized as limited partnerships and has concluded that such companies are entitled to a tax allowance on all partnership interests, or similar legal interests, if the owner of that interest has an actual or potential income tax liability on the public utility income earned through the interest.[39] While this Commission is certainly not bound by the determinations of the FERC, it is noteworthy that existing Commission tax allowance policy applied to SFPP is entirely consistent with the recent FERC order in acknowledging that it is the actual or potential tax impact upon the utility investor that is essentially determinative of utility entitlement to a tax allowance.

One need only look to the Commission's own analysis in the rehearing decision in C. 97-04-025 to understand the fundamental consistency between the FERC's policy on income tax allowances and existing Commission policy regarding tax allowances. D. 99-06-093 succinctly describes the facts that are material to resolution of the tax allowance issue:

> SFPP itself does not in fact pay tax on the income it generates. This is because SFPP is organized as a limited partnership. [footnote omitted] However, this does not mean that income generated by SFPP is tax-free. The income SFPP generates is taxable in the hands of SFPP's owners, regardless of the amount of cash SFPP actually distributes to them. The

[39] "Policy Statement on Income Tax Allowances," May 4, 2005, *111 F.E.R.C. P61,139; 2005 FERC Lexis 1129*. (Attached hereto as Appendix A).

> amount of tax paid on income SFPP generates depends on the tax situation of each of its owners – including the possibility that the tax obligation may be passed on to a further, indirect, owner of SFPP or, ultimately, that the income might be non-taxable.[40]

Indicated Shippers present no policy argument for singling out SFPP, among all the public utilities regulated by the Commission, for punitive treatment. They make no effort to address the discriminatory nature of what is, in effect, a proposed "bill of attainder."[41] They make no claim in this proceeding that any particular rate charged by SFPP for pipeline transportation services is too high. Instead, Indicated Shippers simply rest upon the naive notion that if the partnership itself does not pay taxes then there is no reason why the utility partnership should recover any income tax expenses in its rates.

While Indicated Shippers betray their lack of understanding of the Internal Revenue Code by continuing to cling to the false notion that <u>none</u> of the income generated by SFPP and distributed to its owners is taxable, the Commission has already rejected the Indicated Shipper's fundamental premise that all of the income generated by SFPP escapes taxation. Although the Commission acknowledges in D. 99-06-093 that it cannot determine how much tax is paid on income generated by SFPP, it just as readily recognizes that some of the income generated by SFPP is subject to ultimate taxation:

> Unfortunately, SFPP has a complex ownership structure, making it extremely difficult to determine how much tax is paid on the income it generates, and by whom. SFPP's ultimate owners are removed from the actual operating utility and ownership interests trade on the NYSE. If we

[40] D. 99-06-093, 1999 *Cal PUC LEXIS* 442, *5.

[41] Even if it is assumed that the Commission can lawfully differentiate the tax treatment applied to corporations and partnerships, Indicated Shippers made no effort to explain how the Commission can lawfully differentiate the tax treatment applied to two utilities, both of which are partnerships. In fact, the witness sponsoring Indicated Shippers' tax allowance proposal was unaware of the existence of Pacific Pipeline Systems, a Commission-regulated pipeline that, like SFPP, is formed as a master limited partnership but operates under a combination of cost-of-service and market-based rates. (<u>See</u> Tr. Vol. 4; O'Loughlin at 462-463).

> assume that no tax will be paid on income generated by SFPP when we establish its rate of return, we will run the risk that for some owners, we will have effectively reduced their rate of return.[42]

The Indicated Shippers' tax allowance recommendation, premised on an assumption already rejected by D. 99-06-093, would result in a reduced rate of return for those owners who do have to pay taxes on income distributions from SFPP - the very risk identified by D. 99-06-093 as unacceptable.

In contrast to the lack of legal and policy support for the Indicated Shippers' position, the record reflects ample justification for Commission recognition of a full income tax allowance in determining SFPP's test-period cost of service. As a matter of fundamental fairness, SFPP should not be singled out among all of the state's regulated utilities and subjected to a unique ratemaking policy based simply on its form of organization. Applicability of a uniform tax allowance policy has the advantage of producing the same charges to customers regardless of the form of organization. It also leaves entirely to the management of the utility the choice of form, without imposing direct consequences in the context of a rate decision, and thus allows management to take advantage of the choices offered by the Internal Revenue Code that are best suited to the utility.[43]

In considering whether a partnership should be treated differently from a corporation for tax allowance purposes, it is essential to understand why an income tax allowance is even recognized in a regulated utility's cost of service. When asked the purpose of an income tax allowance in determining a utility's cost of service, Professor Williamson responded as follows:

---

[42] *Id.*, *at *5.*

[43] Ex. 102A; Williamson at 11.

> The answer to the question has to start with why income tax is allowed in rate cases. And it begins with the introduction of very attractive depreciation rates enacted by Congress. The depreciation rates permit rather lower taxes – these ...accelerated depreciation ...rates, permit rather lower taxes than would be the result of using the sort of depreciation that is usually used for ratemaking purposes.
>
> When the privileged depreciation became available, the superior depreciation for tax purposes, the question was whether they will be used by the utilities themselves or whether they might be passed onto ratepayers. The Congressional intent clearly was to provide an incentive for companies to make investments, in which case the companies rather than the customers should benefit from the depreciation.
>
> When some regulatory Commissions began to use flow through, which diverted the benefits of the tax rules to the customers away from the company, Congress responded by saying if you are going to defeat our purpose of incenting investment, we will not permit these accelerated depreciation rates. The result was that the regulatory Commissions had to stop diverting the tax benefits that were gained by using flow through and had to restore them to the utilities.
>
> Now that is why the tax allowances are standard for incorporated utilities or utilities owned by corporations. Ultimately, the purpose is to support the Congressional purpose of providing an incentive for investment. And the California Commission has so far treated partnerships just the way it treats corporations with respect to income tax items.[44]

By allowing energy limited partnerships, like SFPP, to take advantage of the same attractive depreciation rates that are available to energy utility corporations, Congress has expressly indicated its intention that energy limited partnerships should enjoy incentives for reinvestment similar to those it has deemed appropriate for utility corporations.[45] It is, of course, just as important to the welfare of the state for SFPP to invest in its pipeline infrastructure as it is for PG&E, a utility corporation, to invest in its transmission and distribution infrastructure.

---

[44] Tr. Vol. 2; Williamson at 209-210.
[45] Tr. Vol. 3; Williamson at 295, lns. 10-17.

Denial of a tax allowance to SFPP because it is a partnership, rather than a corporation, would deny SFPP funds for investment in direct contravention of congressional intent.

Elimination of a tax allowance would have a devastating impact not only upon SFPP's ability to invest in infrastructure but also upon its ability to maintain existing operations. Rejection of a tax allowance for SFPP would reduce SFPP's 2003 Test Year cost of service of $108,590,00 by $14,639,000 or about 14%.[46] If SFPP were required to reduce its revenue requirement by 14% (and its rates by 7%) just to reflect elimination of a tax allowance, a strict cost-of-service approach could easily result in rates for certain segments that would be too low to justify continued operation.

SFPP presented testimony showing that, at a certain point, implementation of a strict cost-of-service regime, further compounded by an arbitrary 14% reduction in revenue requirement, will provide no return on SFPP's investment and will eliminate any incentive to continue to operate still-useful pipelines and to assume the substantial risk exposure that comes with operation of a pipeline.[47] Under a cost-of-service approach, as pipeline investments depreciate, the associated rate base is reduced, along with the value of the investment upon which the pipeline is entitled to earn a return. Over time, this rate base (and the corresponding return that the pipeline can earn) approaches zero, irrespective of the continuing operational vitality of the pipeline. Unlike other major utilities, SFPP does not make substantial investments every year to expand its system. Without these ongoing annual investments, SFPP's rate base will decline to the point where the nominal funds received, even if at an excessive rate of return, are not sufficient to compensate for the risks incurred.

---

[46] Ex. 200A; O'Loughlin at 6.

[47] Ex. 106A; Cox at 47-48.

There is nothing redeeming about the Indicated Shippers' proposal to deny SFPP an income tax allowance. It has no precedent and would treat SFPP like no other energy-related utility in the state, much less the country. It runs counter to Commission D. 99-06-093 and other Commission decisions intended to effectuate congressional enactments designed to encourage investment in energy utility infrastructure. It is punitive and discriminatory.

By contrast, there is every reason, including fairness and consistency, for the Commission to apply its existing policy by providing a full income tax allowance in determining the 2003 TY cost of service to be applied in support of SFPP's rates for the period January 1, 2004 and beyond.

3. <u>SFPP's Assumed Rate of Return for Test Year 2003 Is Reasonable</u>.

To arrive at reasonable assumptions regarding capital structure, cost of debt, and cost of equity to be used in calculating SFPP's TY 2003 cost of service, SFPP relied upon the expertise of Professor Peter Williamson. Because SFPP does not undertake its own financing, Professor Williamson concludes that it is appropriate in this proceeding to use the debt cost and the capital structure of KMEP, the entity that ultimately manages and finances SFPP's operations.[48]

Professor Williamson recommends use of a capital structure consisting of 60% equity and 40% debt and representing the capital structure that KMEP's management believes is most appropriate for it and towards which the management intends to move the actual capital structure. Calculation of the weighted average cost of debt for KMEP shows it to be 7.08% at

[48] Ex. 102A; Williamson at 2.

December 31, 2002.[49] Based upon his analysis of the required return on common equity for a set of publicly traded oil pipeline proxy companies, Professor Williamson concludes that a reasonable determination of the cost of equity for SFPP is 15.86%.[50]

Indicated Shippers contest each of SFPP's assumption regarding capital structure, cost of debt, and cost of equity. Indicated Shippers recommend the following alternatives: (1) a capital structure consisting of 44.1% equity and 55.9% debt; (2) cost of debt of 6.41%; and (3) cost of equity of 12.8%.[51]

As set forth below, SFPP submits that Professor Williamson's recommendations regarding capital structure, cost of debt, and cost of equity most reasonably reflect circumstances and conditions likely to obtain during the test period and beyond and should therefore be incorporated by the Commission in determining SFPP's Test year 2003 cost of service.

a. SFPP's assumed capital structure is reasonable

KMEP has declared that a 60/40 equity-to-debt capital structure is most appropriate for it and has further indicated that, as circumstances allow, it intends to move the actual capital structure to 60% equity and 40% debt. In adopting an appropriate capital structure for purposes of determining SFPP's cost of service, the Commission, while attentive to current facts and circumstances, must also be mindful of conditions and circumstances that are likely to obtain in the future. Given that SFPP is not a typical monopoly utility, subject to periodic

---

[49] Mr. Turner's calculation of SFPP's Test Year 2003 cost of service assumes a 6.66% cost of debt, rather than the 7.08% found to be reasonable by Professor Williamson, resulting, if anything, in an understatement of SFPP's cost of service.

[50] Ex. 102 A; Williamson at 2; <u>also</u> Ex. 103A; Williamson, Attachment JPW-3Ax.

[51] The impact upon the calculation of SFPP's cost of service associated with the parties' different positions regarding capital structure, cost of debt, and cost of equity is as follows: (1) differences in capital structure (60% equity v. 44.1% equity) - $4,789,000; (2) differences in cost of debt (6.66% v. 6.41%) - $148,000; and (3) differences in cost of equity (15.86% v. 12.8%) - $4,589,000. (<u>Cf.</u> 200A; O'Loughlin at 18-29).

Commission assessment of its cost of service, it is particularly important that the Commission refrain from restricting its analysis to historical data and instead give fair consideration to circumstances which are likely to be representative of future conditions.

It is inappropriate for Indicated Shippers to ignore the "target" capital structure established by KMEP. This is the capital structure generally used for cost-of-capital calculations within a corporation, on the grounds that it is the "norm" to which the company is trying to move. There are several reasons for temporary abnormal capital structures in a corporation, particularly in the oil pipeline industry. Growth through acquisitions has been common and debt financing is particularly attractive in such cases because large amounts of debt can be placed quickly at recently low interest rates. The intention, however, is generally to replace debt with equity when this is feasible.[52]

TEPPCO is a good example of this process. TEPPCO has made many acquisitions in recent years, followed by issues of new equity. Testimony of Indicated Shippers shows an equity ratio for TEPPCO of only 38.6% at March 31, 2003.[53] But by June 30 that ratio had risen to 41%, and adjusted for the issue of new units by way of a prospectus dated August 7, 2003, it rose to 45%.[54]

In contrast to Indicated Shippers' projection of a 44/56 equity-to-debt ratio for SFPP, the capital structure set out on KMEP' balance sheet in its March 31, 2003 SEC Form 10-Q was 47.5% equity and 52.5% long-term debt. And even this included a substantial amount of short-term debt.[55]

---

[52] Ex. 103A; Williamson at 3.
[53] Ex. 200A; O'Loughlin, Attachment B).
[54] Ex. 103A; Williamson at 4).
[55] *Id.*

It is known that KMEP intends to move to a capital structure of 60% equity and 40% debt. The fact is that interest rates have hovered at historically low levels for several years. When debt is very cheap, whatever the long-run target capital structure may be, it is likely to be to the advantage of the enterprise and its customers to make use of that cheap debt. Conversely, in a period of rising interest rates, there would be a lot more incentive to move towards less debt and more equity.[56] Given KMEP's determination that a 60/40 equity-to-debt ratio is optimal to finance the needs of the businesses which it operates along with the prospect that interest rates will inevitably rise in the future, it is reasonable to assume that a 60/40 capital structure best reflects future conditions under which financing for SFPP will be provided by KMEP. As Professor Williamson testified: "The 60/40 ratio is appropriate at the present time in the context of risks to an oil pipeline."[57]

b. SFPP's assumed cost of debt is reasonable.

Professor Williamson's calculation of SFPP's cost of debt at 7.08% as of December 31, 2002 is correct, while Indicated Shippers' claimed calculation of SFPP's cost of debt of 6.41% as of March 31, 2003 is not.

Determination of the cost of long-term debt for KMEP is a complicated business because of the mix of short-and long-term debt and the variety of financing instruments used by KMEP, many of them special purpose financing that could not have been used to finance SFPP. In his Answering Testimony in Trailblazer Pipeline Company, Docket No. RP03-162, filed with the FERC on July 29, 2003, Mr. Bruce H. Newsome, Vice President, Rates and Certificates for the operator of Trailblazer, a subsidiary of KMEP, stated as follows:

---

[56] Tr. Vol.3; Williamson at 311.
[57] Ex. 102A; Williamson at 2.

> The cost of debt [for Trailblazer], as developed by Professor Williamson, is 7%. For comparison purposes, the debt cost rates for KMI and KMEP are 7.03% and 7.08%, respectively, at March 31, 2003, and [FERC] Staff witness Knight's debt cost rate is 7.05%. The KMI and KMEP cost figures represent actual debt cost adjusted for issuance costs. In the case of KMEP, I have excluded the cost of commercial paper from the calculated cost of debt. Even though for accounting purposes commercial paper is classified as long term debt, it is unlike KMEP's other fixed rate debt. Commercial paper represents 1 to 30 day obligations and bears a totally nonrepresentative interest rate, currently 1.43%. The amount and rates applicable to commercial paper both fluctuate significantly from month to month. If commercial paper were included, KMEP's debt cost would be 6.5%. But this rate does not accurately represent KMEP's long-term financing cost.[58]

c. SFPP's assumed cost of equity is reasonable.

It is impossible to establish directly the cost of equity for SFPP because SFPP has no equity securities that are publicly traded. Consequently, Professor Williamson identified a group of publicly traded oil pipeline companies as appropriate proxies for SFPP and concluded that the risk to investors in SFPP is approximately the same as the average risk in the proxy companies that he identified. Relying upon the Discounted Cash Flow ("DCF") method, he determined the cost of common equity for the proxy companies.[59] The results of his analysis showed an average cost of equity of 15.86% for the proxy companies. Professor Williamson concluded that there is no reason to believe that the cost of equity for SFPP differs from the 15.86% average, and he recommended use of that average in this proceeding.[60]

None of the three objections raised by Indicated Shippers regarding Professor

---

[58] Ex. 103A; Williamson at 5.

[59] The "market based" DCF model can only be applied to companies for which the common stock is publicly traded, and the equity in SFPP is not publicly traded. SFPP is a subsidiary of KMEP, and KMEP equity is publicly traded. However for purposes of determining the cost of equity, Professor Williamson chose to make use of a set of publicly traded oil pipeline partnerships, rather than rely on KMEP alone. Use of the combined data for a set of companies, where errors tend to cancel one another, is likely to be more reliable than use of a single company's data. (See Ex. 102A; Williamson at 5).

[60] Ex. 102A; Williamson at 10; also Tr. Vol. 3; Williamson at 315; lns. 6-8.

Williamson's cost of equity analysis has merit. Indicated Shippers first question Professor Williamson's use of cash distributions per unit in his DCF analysis of five oil pipeline proxy companies.[61] All five are Master Limited Partnerships (MLPs) and have been used for some time as oil pipeline proxy companies in FERC proceedings. The DCF methodology equates the value (the stock price) of a share of stock to the discounted present value of the cash distributions expected by investors. The discount rate is the cost of equity.[62]

While Indicated Shippers' expert witness now recants, he himself used MLP distributions in his DCF analysis in the FERC proceeding, SFPP Docket No. OR96-2-000 et. al in 2001.[63] His reasoning for rejecting in this proceeding the use of actual cash distributions by the proxy companies in a DCF analysis simply does not hold up, as explained in detail by Professor Williamson.[64]

Indicated Shippers further criticize Professor Williamson's analysis on grounds that it improperly uses the IBES-reported earnings growth forecasts to represent the growth rate in the DCF formula.[65] The theory underpinning the Indicated Shippers' critique, i.e. that the cash distributions represent a return of capital and that distributions cannot possibly grow as fast as earnings, is simply wrong and is thoroughly discredited by Professor Williamson's rebuttal testimony.[66]

In response to the third criticism levied by Indicated Shippers against SFPP's recommended 15.8% cost of equity, Professor Williamson repeated his calculations, using – as

---

[61] Ex. 200A; O'Loughlin at 23-24.
[62] Ex. 103A; Williamson at 6.
[63] *Id.*
[64] Ex. 103A; Williamson at 6-8).
[65] Ex. 200A; O'Loughlin at 24.
[66] Ex. 103A; Williamson, Attachment JPW-4).

the distribution figures for his proxy companies – the averages of January/February distributions and April/May distributions, rather than the average stock prices over six months and the most recent dividend declared for the proxy companies.[67] Professor Williamson's exercise served only to validate his recommended 15.86% cost of equity for SFPP.

Indicated Shippers recommend a cost of equity of 12.8%, purportedly based on a corrected alternative formulation of Professor Williamson's DCF methodology as well as a review of recent Commission-allowed returns.[68] In contrast to the validity of Professor Williamson's cost-of-equity recommendation, the analysis of the Indicated Shippers supporting their recommended 12.8% cost of equity is rife with error.

The alternative formulation upon which the Indicated Shippers rely is a discounted *income* model and <u>not</u> a discounted *cash flow* model as is the DCF model. Professor Williamson testified that no discounted income model has ever been explained or justified, to his knowledge, in any respectable publication. The DCF model rests on the proposition that what investors want from their investments is cash, and they value their investments at the present value of the cash receipts they expect in the future. With cash they can purchase goods and services, or further investments. Income per share is an accounting concept. Investors may indeed be interested in reported income per unit but they cannot buy goods and services with income per share reports.[69]

Indicated Shippers base their model on the mistaken conjecture that use of the actual cash distribution data cannot be correct – a theory that Professor Williamson has thoroughly discredited. Indeed, Professor Williamson provided proof that Indicated Shippers are

[67] Ex. 103A; Williamson at 9.
[68] Ex. 200A; O'Loughlin at 22).
[69] Ex. 103A; Williamson at 9.

exactly wrong in contending that earnings must fall as the result of distributions in excess of earnings by demonstrating substantial earnings growth for various entities, including KMEP, whose distributions have exceeded earnings.[70] Relying on a discredited theory, Indicated Shippers use the income figures in a manipulation of what is represented to be what the true distributions should have been to fit the DCF model. In doing so, Indicated Shippers make the entirely arbitrary assumption that income per unit is the "correct" distribution figure to use. This choice of which income figure to match with which unit price is entirely arbitrary. Professor Williamson testified that he had never seen a regulatory decision that agreed with Indicated Shippers' peculiar, alternative formulation and use of the DCF model.[71]

Given the patent arbitrariness of their cost of equity analysis, Indicated Shippers vainly attempt to justify their 12.8% cost-of-equity recommendation by way of a comparison to Commission allowed equity returns. Simply put, the comparisons provide no relevant guidance to the Commission, much less support a determination that 12.8% represents a reasonable cost of equity for SFPP.

Indeed, the Indicated Shippers' choice of companies to compare to the five oil pipeline proxy companies is a strange one. Edison International was, for the period under review, still in serious financial condition and had not paid a dividend since 2000. PG&E was in no better condition, with its Pacific and Gas Electric subsidiary in bankruptcy, and no dividends paid since 2000. Sempra Energy was probably in better condition. Value Line, in its report of May 16, 2003, said, "The stock has some speculative appeal." The fourth company cited by Indicated Shippers for comparison is Sierra Pacific Resources, which appeared to be in some

[70] *Id.* at 7-8; also Attachment JPW-4.
[71] *Id.* at 10.

difficulties, with Value Line, in its May 16, 2003 report, stating: "We advise investors to bypass these shares. The regulatory and financial risks, potential earnings dilution, and likelihood of no common dividend restoration for a while make the equity unappealing."[72]

Briefly, none of the four is at all comparable to the set of proxy companies utilized by Professor Williamson – a comparability that is necessary to determine a representative cost of equity for SFPP. It is almost impossible to apply any known methodology to estimate with reasonable reliability the cost of equity for any one of them. The rates of return allowed by the Commission are simply no guide to what investors actually expect and require of those companies.

There is a further reason to disregard Indicated Shippers use of the four electric utilities. Indicated Shippers claim that their recommended cost of equity for SFPP is supported by a risk comparison with the four electrics.[73] While Indicated Shippers rely on beta coefficients published by Value Line to support their conclusion, the beta coefficients are quite useless as risk measures.

Beta coefficients are an element of the Capital Asset Pricing Model ("CAPM"). The beta coefficient is a measure of the change in rate of return on a stock relative to the change in rate of return on a stock market index. The theory of the CAPM is that moves in the market translate into moves in the stock and the beta coefficient reflects the magnitude of the market influence on the stock, and is therefore a useful measure of market risk in the stock. But the validity of the theory requires that there actually be a significant relation between rates of return on the stock and on the market index.[74]

---

[72] Ex. 103A; Williamson at 10.
[73] Ex. 200A; O'Loughlin at 29.
[74] Ex. 103A; Williamson at 10-11.

The R-Squared is the statistical measure of the relationship. An R-Squared of 1.00 indicates that the stock and the market are perfectly correlated and move in lock step. An R-Squared of zero indicates that there is no relationship at all. Value Line does not reveal just how it determines the beta coefficients it publishes, yet Indicated Shippers rely on these beta coefficients. Nor does Value Line publish any statistics, such as the R-Squared, to establish the reliability of its beta coefficients.

Ibbotson Associates, on the other hand, explains exactly how its beta coefficients are calculated and publishes semi-annual tables of beta coefficients together with values of the R-Squareds. For each company referenced in the testimony of Indicated Shippers, Professor Williamson tabulated both the beta coefficient and the R-Squared statistic published by Ibbotson Associates as of December 1999 and June 2003 (the dates chosen by Indicated Shippers for their comparison). The low values of the R-Squared numbers (close to zero), especially as of June 2003, indicate that there is almost no relationship between the performance of any of the stocks and the performance of the market.[75] In other words, the beta coefficients are no better than random numbers as risk measures. Indicated Shippers' beta coefficient comparison cannot be relied on.

4. SFPP's Allocation of Test Year General and Administrative ("G&A") Expenses Incurred by KMEP on Behalf of SFPP Is Reasonable.

SFPP accounts for investment and operating expenses in its books and records by "location" code, FERC account code and SFPP general ledger detail account code. A location code typically represents a physical facility such as a pump station, pipeline segment or storage terminal. Costs incurred at facilities that are directly associated with a specific service or system

[75] *Id.* at 11-12.

are referred to as "direct costs." Conversely, general overhead costs, referred to as "indirect costs," are not directly attributed to a specific service or system and therefore require allocation.[76]

Attachment D to SFPP's Application described in detail the allocation methodologies used to derive a CPUC-jurisdictional level of costs for investment and operating expenses. The allocation methodologies set forth in Attachment D to SFPP's Application are consistent with allocation methodologies used in SFPP's cost of service development for FERC-jurisdictional related purposes, and they were followed by SFPP in its development of its 2003 Test Year cost of service.[77] Overhead costs incurred by KMEP are among the costs allocated to SFPP in accordance with the above-referenced allocation methodologies. The general and administrative, or overhead, costs are incurred by KMEP's general partner, Kinder Morgan G.P., Inc., in performing various corporate oversight and support activities in KMEP's Houston, Texas and Orange, California headquarters for KMEP subsidiaries. The activities include payroll and benefits, insurance, executive management, corporate development activities, treasury and finance activities, general corporate legal activities, and other activities.[78]

SFPP, as a subsidiary of KMEP, receives an allocated share of KMEP general and administrative overhead expense. The allocation methodology employed by KMEP is a FERC-prescribed allocation formula called a "Massachusetts Formula" that utilizes the average of three factors – gross revenue, gross property, and direct payroll – for each subsidiary, as a percentage of total KMEP costs for each of those factors. In 2002, SFPP's total share of KMEP allocated

[76] Ex. 104A; Turner at 5-6.
[77] *Id.* at 6.
[78] Ex. 105A; Turner at 16.

overhead amounted to approximately $30 million. This $30 million is then subject to further allocation to SFPP's CPUC-jurisdictional operations.[79]

Indicated Shippers contest SFPP's allocation of KMEP overhead costs, challenging how much KMEP overhead is allocated to SFPP and how SFPP's overhead-related costs (including its allocated share of KMEP overhead) are allocated between carrier (i.e. regulated operations) and non-carrier operations. The two exceptions taken by the Indicated Shippers to SFPP's overhead allocations, if given effect, would produce a reduction in SFPP's CPUC-jurisdictional operating expense by $5.8 million.[80]

a. SFPP's allocation of KMEP overhead to SFPP California jurisdictional operations is reasonable.

Indicated Shippers recommend two general changes to the KMEP Massachusetts Formula: (i) an adjustment to the KMEP Massachusetts Formula to include all KMEP subsidiaries by tying to gross revenue and gross property as reported in KMEP's 2002 10-K Report; and (ii) reduction of the gross property factors of the Formula to remove purchase accounting adjustments.[81] Neither of the two recommended changes is justified.

(1) The Massachusetts Formula vis-à-vis KMEP's 2002 10-K Report:

The concern of Indicated Shippers that they cannot tie SFPP's allocations under the Massachusetts Formula to gross revenue and gross property data set forth in KMEP's 2002 10-K Report is a classic red herring. Although Indicated Shippers assert that SFPP's allocated

---

[79] *Id.* at 16.

[80] Changes recommended by Indicated Shippers to the amount of KMEP overhead allocated to SFPP would improperly reduce SFPP's test year operating expenses by $3.6 million. Changes recommended by Indicated Shippers to the amount allocated between carrier and non-carrier operations would improperly reduce SFPP's test year operating expenses by $2.2 million. (See Ex. 105A; Turner at 16).

[81] Ex. 200A; O'Loughlin at 35-37.

share of KMEP overhead is "substantially overstated," they next admit that there was insufficient time to review relevant discovery data in detail.[82] Apparently, based upon their own failure to review available data, Indicated Shippers assume a "guilty until proven innocent" approach to evaluating SFPP's overhead allocations. Indicated Shippers automatically render KMEP's Massachusetts Formula invalid just because they have not sought, and thus not received, an explanation for reconciling their perceived differences between the Massachusetts Formula data and data from the KMEP 2002 10-K Report.

Acting blindly, Indicated Shippers then proceed to compare the Massachusetts Formula data provided in discovery to KMEP's 2002 10-K Report and, based upon that comparison, to recommend sweeping changes to the Formula in order to artificially force the gross revenue and gross property factors in the Formula to tie to consolidated values as reported in KMEP's 10-K Report. Not surprisingly, the heavy-handed adjustments proposed by Indicated Shippers result in a mismatch of subsidiaries in the Formula to the overhead expense that is to be allocated.[83]

SFPP has provided testimony explaining the reasons for the differences between what is shown in KMEP's Massachusetts Formula for gross revenue and gross property versus what is reported by KMEP in its 2002 10-K report. That testimony shows that KMEP's 2002 Massachusetts Formula actually consists of two tiers. The first tier is for allocating KMEP overhead costs in the Houston, Texas office to all applicable subsidiaries of KMEP while the second tier allocates KMEP overhead costs in the Orange, California office to only the products pipeline subsidiaries. A summary Formula was provided as well as the monthly gross property

[82] *Id.* at 36.
[83] Ex. 105A; Turner at 17.

detail for a 13-month average. It was further indicated that KMEP uses a 13-month average for the gross property factor of the Formula to properly take into account the changes that occur during the year as a result of acquisitions. Using a simple average of the beginning and end-of-year amounts would not accurately reflect these changes.[84]

The differences between what is shown in KMEP's Massachusetts Formula for gross revenue and gross property versus what is reported by KMEP in its 2002 10-K Report have been set forth in ample detail in SFPP's rebuttal testimony, along with an explanation of the reason for any difference.[85] Briefly summarized, the detailed information shows, among other things, which KMEP subsidiaries are excluded from the Massachusetts Formula allocation of KMEP overhead and describes the factual circumstances that render their inclusion contrary to an accurate allocation of the overhead costs.[86]

Similarly, the testimony shows that while the revenues and assets of certain subsidiaries are excluded from KMEP's consolidated revenues and property, they are nonetheless included for purposes of applying the Massachusetts Formula in order to ensure that KMEP overhead costs are properly allocated to all entities that benefit from the incurrence of the costs.[87] The resulting KMEP overhead allocation for SFPP given proper application of the Massachusetts Formula amounts to $29.7 million[88] of KMEP's total overhead of $113.1 million. The Indicated Shippers' recommended SFPP-allocated amount of only $16.5 million is

[84] *Id.* at 18.

[85] *Id.* at 18-20.

[86] *Id.* at 20.

[87] *Id.*

[88] The total overhead for SFPP of $29.749 million is slightly less than the $30.004 million amount that was actually allocated to SFPP during the 2002 calendar year. This difference is a result of "truing up" the values in the formula for final year-end numbers reported in KMEP's financial statements that were not available at the time the December allocation of overhead expense was recorded. This difference, amounting to $0.1 million at the CPUC-jurisdictional *(footnote continued)*

completely baseless as would be expected given Indicated Shippers' admission that they have not considered the relevant data in making their recommendation. As further evidence of their baseless position, despite their admitted lack of understanding, Indicated Shippers chose not to cross examine SFPP witness Turner on any of these reconciling differences. Predictably, Indicated Shippers' calculations are manifestly incorrect and should be rejected.

(2) Unjustified reduction of the gross property factors of the Massachusetts Formula by removing purchase accounting adjustments:

Indicated Shippers propose yet another unprecedented and arbitrary adjustment that would reduce the gross property factors of the Massachusetts Formula by eliminating any portion of the property valuation that reflects a premium or what is referred to as a purchase accounting adjustment ("PAA").[89] However, even if such an adjustment were appropriate, which it is not, Indicated Shippers' have erred in their own adjustment by not removing the PAA's for every subsidiary in KMEP's Massachusetts Formula, thus creating a hodge-podge of meaningless and inconsistent values.

The only rationale advanced by Indicated Shippers to support the position that the PAA's fundamentally should be excluded is that PAA's do not reflect the original cost of the assets. Based upon this non sequitur, the Indicated Shippers then conclude that including the PAA's would be inconsistent with the original cost rate base, and, therefore, should not be permitted for ratemaking purposes.[90] Indicated Shippers provide no explanation why the original cost of assets, which are in fact used strictly for regulatory rate base development, is a valid basis for allocating the responsibility for overhead services among KMEP's various subsidiaries.

---

level, is inconsequential.

[89] Ex. 200A; O'Loughlin at 36-37.

[90] *Id.*

In contrast to the lack of rationale supporting the Indicated Shippers' suggested adjustment, SFPP has relied upon an allocation methodology that has the objective of allocating overhead costs in a way that tracks the management services that are provided and the represented costs. The value of a company's capital investment in its operations is a more reasonable measurement to use in the matching of these services to the incurrence than would some notional value of the assets' original cost used strictly for regulatory rate base purposes.[91]

b. SFPP's allocation of overhead costs between carrier and non-carrier operation is reasonable.

SFPP allocates overhead-related costs, including its share of allocated KMEP overhead, between its carrier and non-carrier operations using another FERC-prescribed allocation formula known as the "Kansas/Nebraska Formula," or simply "K/N Formula." The K/N Formula utilizes two factors – carrier gross property and carrier direct payroll – applied to total SFPP values to determine the overhead amounts allocable to SFPP's carrier operations.[92]

Indicated Shippers also propose to adjust SFPP's K/N Formula allocation in the same manner they proposed to adjust KMEP's Massachusetts Formula, i.e. by again removing the PAA's from the gross property factors. As a result of this equally unjustified adjustment, Indicated Shippers produce a carrier allocation ratio of 78.37 percent versus SFPP's ratio of 81.38 percent.[93]

For the same reasons previously discussed regarding the merits of reflecting financially reported gross property in the Massachusetts Formula, the same holds true for the K/N Formula. That is, in removing the PAA's, Indicated Shippers would have the Commission

[91] Ex. 105A; Turner at 21.
[92] *Id.* at 24.
[93] *Id.*

ignore the fundamental purpose of the allocation formula, which is to ensure that overhead costs are fairly distributed among all operations that benefit from their incurrence. SFPP's financially reported gross property values for both carrier and non-carrier assets, used in the K/N Allocation Formula, reflect the value that KMEP paid for all of SFPP's assets and thus reflect the value that management gives to the various assets. These amounts, which include PAA's, are more accurate for use in determining accountability for overhead services than using original cost values. The original cost values, which Indicated Shippers recommend, say nothing about the relative value that management places on the assets, which is the entire purpose for using a gross property factor in allocating overhead costs.[94]

The concerns expressed by Indicated Shippers regarding the alleged deficiencies of SFPP's allocations are completely without merit. Indicated Shippers admit that they have not reviewed all the data. Furthermore, the proposed elimination of the purchase accounting adjustments has not rationale basis and improperly skews the overhead allocations. For these reasons, the adjustments to SFPP's expense allocations proposed by the Indicated Shippers should be rejected entirely.

5. SFPP's Test Year Estimate for Fuel and Power Expense Is Reasonable.

Despite the apparent confusion surrounding the issue, the basis for SFPP's recommended adjustment of its recorded 2002 power expenses to reflect the level of related costs anticipated during the test period is quite straightforward and just as reasonable. Starting with 2002 actual fuel and power expenses, SFPP made three test year adjustments: (1) an increase of $3.4 million reflect energy surcharges imposed by the Commission in November, 2002 upon direct access customers, including SFPP (along with an offsetting reduction in power costs to

[94] *Id.* at 25).

reflect an anticipated decline in test year volumes); (2) a decrease of $0.6 million to reflect a decrease in the cost of Drag Reducing Agents ("DRA") resulting from lower test year volumes and a lower anticipated price per gallon for DRA; and (3) a decrease of $0.6 million to reflect operational savings associated with the North Line Expansion.[95] The effect of these referenced test year adjustments is an increase of $2.2 million over actual 2002 fuel and power expense.

Indicated Shippers propose to eliminate all of SFPP's test year adjustments for fuel and power expense in their entirety and instead to rely upon actual 2002 fuel and power expense as a more appropriate indicator for 2003 test year purposes.[96] Their reasons for attempting to freeze SFPP's fuel and power expenses reflect such a fundamental misunderstanding of the rates that SFPP actually pays for power that their recommendation must be rejected.

It is true that the justification for SFPP's Advice Letter 14 electric surcharge rate increase reflected SFPP's status as a bundled electricity customer subject to a 1 cent/kWh surcharge (imposed January, 2001) and a 3 cent/kWh surcharge (imposed March, 2001) approved by the Commission for both PG&E and Southern California Edison Company ("Edison"). It is also true that Direct Access customers were exempted from the 3 cent/kWh surcharge, while only Direct Access customers in Edison's service territory were further exempted from the 1 cent/kWh surcharge. In turn, Direct Access customers in Edison's service territory were subjected to a 2.7 cents/kWh surcharge as of August, 2002[97] while Direct Access customers in PG&E's service territory were subjected to a 2.7 cents/kWh surcharge approved by

[95] Ex. 105A; Turner at 13.
[96] Ex. 200A; O'Loughlin at 33.
[97] D. 02-07-032.

the Commission in November, 2002 but effective as of January 1, 2003.[98] Finally, it is true that starting in October-November, 2002, SFPP switched many of its major power accounts with PG&E and Edison from bundled service to direct access service.

However, it is certainly not true, contrary to Indicated Shippers testimony, that if SFPP is a Direct Access customer of Edison and PG&E and faces the August, 2002 and January, 2003 Direct Access surcharges imposed by Edison and PG&E respectively (which is, in fact, the case) "then SFPP became a Direct Access customer prior to September 20, 2001 and has not been paying the 1 cent and 3 cent surcharges that were the basis of its increases in tariff rates as stated in Advice Letter No. 14."[99] Rather, SFPP did pay the 1 cent and 3 cent surcharges as a bundled customer until it began switching major accounts to direct access in late 2001. During 2002, SFPP direct access accounts in Edison's service territory paid neither the 1 cent/kwh nor 3 cent/kwh charge billed to bundled customers but, as of August, 2002, were billed the 2.7 cents/kWh direct access surcharge. Similarly, during 2002, SFPP direct access accounts in PG&E's service territory did pay the 1 cent/kWh surcharge as well as the 2.7 cent/kWh direct access surcharge authorized by the Commission in November, 2002 and billed as of January 1, 2003.

As a further clarification, Edison's August, 2003 bundled customer rate decrease that Indicated Shippers suggests should serve to decrease SFPP's 2003 Test Year fuel and power expense adjustment has not been realized by SFPP given that its major accounts in Edison's service territory remain under direct access service.[100]

---

[98] D. 02-11-022.
[99] Ex. 200A; O'Loughlin at 34).
[100] Ex. 200A; O'Loughlin at 34.

In the context of an accurate understanding of the facts, it is disingenuous for Indicated Shippers to suggest that SFPP has played some form of "bait and switch" with the Commission by seeking rate increases based upon its status as a bundled customers and then by switching to direct access service to avoid the charges that were the basis of the requested relief sought by SFPP.[101] As a bundled customer in June, 2001, SFPP incurred the increase in electricity costs anticipated by its Advice Letter 14. The fact that SFPP switched to direct access service in late 2001, thereby avoiding some but not all of the bundled customer surcharges, does not mean that SFPP as a direct access customer suddenly began to avoid the $500,000/month increase in power costs that were anticipated by Advice Letter 14. Direct access customers were not immunized from the substantial increases in electricity experienced by all Californians as result of the energy crisis. In fact, it can be readily demonstrated that power costs incurred by SFPP, despite its status as a direct access customer in 2002, did reflect increases on the order of $500,000/month in comparison to power costs incurred by SFPP prior to the filing of Advice Letter 14.

That brings us back to the question of the reasonableness of SFPP's proposed test year adjustment for fuel and power expenses. It is undeniable that SFPP, as a direct access customer, will be subject to greater expenses for its electricity purchases that were recorded in year 2002. That is so because year 2002 actual expenses do not reflect the 2.7 cent/kWh surcharge that PG&E was authorized to impose on its direct access customers which charge, while authorized by the Commission in November, 2002, was not put into effect until January 1, 2003.[102] To validate the reasonableness of SFPP's proposed adjustment, actual 2003

---

[101] Ex. 200A; O'Loughlin at 34.
[102] PG&E Advice Letter 2328-E.

(annualized) electric power and DRA expense were compared to SFPP's estimated 2003 test year costs. This comparison shows that SFPP's test year adjustments are reasonable.[103] This comparison also shows that the suggestion of Indicated Shippers to freeze costs at 2002 recorded levels is inappropriate.

It is simply illogical to assume, as Indicated Shippers do, that SFPP power costs will remain static at 2002 levels. The facts show otherwise and demonstrate the reasonableness of SFPP's proposed $2.2 million adjustment to Test Year 2003 fuel and power expenses.

6. SFPP's Adjustment of Test Year Expenses Related to Oil Losses & Shortages Is Reasonable.

"Oil losses and shortages" pertain to an expense account that primarily captures the difference between volumes tendered into the pipeline systems at the injection points and volumes delivered at the destination points. A contributing factor to the level of losses/shortages reflected in the account involves metering imperfections. While it is impossible to calibrate injection and destination meters without any discrepancies, pipelines are subject to fairly restrictive tolerances for the accurate measurement of injections/withdrawals.

Although SFPP has always been within these tolerances, it recently embarked on an increased effort to minimize these differences. In 2002, SFPP's concerted effort to improve measurement accuracy resulted in reduced "gains" starting in the second half of the year. SFPP's future oil losses and shortages are anticipated to be much smaller than what SFPP has historically recorded prior to mid-2002, as evidenced by SFPP's actual experience for the second half of 2002 and the first eight months of 2003, which year-to-date has been $2.2 million. Since this procedure improvement took place mid-2002, SFPP proposes to adjust the base period actual

[103] Ex. 105A; Turner, Attachment B.

amounts by annualizing July through December 2002 values, resulting in an increase of $1.6 million to CPUC-jurisdictional operating expense for test period purposes.[104]

Indicated Shippers take exception to the proposed test year adjustment relating to SFPP's losses/shortages account. Indicated Shippers do agree that as a result of SFPP's metering improvement program, a test year adjustment is appropriate. Accordingly, Indicated Shippers increased SFPP's actual 2002 expenses by $1.0 million, in contrast to SFPP's proposed $1.6 million adjustment. However, Indicated Shippers disagree with the ongoing impact that SFPP's 2002 metering calibration program will have.

As the basis for their challenge, Indicated Shippers rely on a SFPP data response indicating such a program is conducted every five years. Indicated Shippers assume that SFPP's historic oil losses and shortages are the best predictor of what to expect in the future and accordingly calculate their test year adjustment using a 1998-2002 five-year average.[105]

SFPP submits that Indicated Shippers have erred in relying on SFPP's data response as the sole basis of their test year adjustment. SFPP's historic oil losses and shortages are not indicative of future operations. Although SFPP's meter discrepancies have been within acceptable industry tolerances, SFPP has consistently recorded fairly sizable gains (*i.e.*, negative expense) each year. As a result of the meter improvements, the gains in SFPP's oil losses and shortages account were considerably lower for the second half of 2002 and for 2003 through August. SFPP's oil losses and shortages are anticipated to remain lower in the future. Thus, SFPP's test year adjustment – which annualizes the last six months of 2002 – better reflects future operations than does the treatment proposed by Indicated Shippers.

[104] Ex. 104A; Turner at 14.
[105] Ex. 200A; O'Loughlin at 30-31.

In fact, review of most recent oil losses and shortages recorded by SFPP indicates that results of recent operations are consistent with SFPP's proposed test-year adjustment. Review of SFPP's January through August 2003 data, properly annualized, demonstrates that there has been a system-wide "gain" of $3.4 million (*i.e.*, negative expense), an amount which is quite close to SFPP's proposed test year amount of $3.0 million.[106] Indicated Shippers' proposed adjusted gain of $4.5 million, on the other hand, is not consistent with current operations and should be rejected.

7. SFPP's Adjustment of Its Cost of Service to Reflect DR&R Expenses Is Justified.

SFPP has recommended that only two regulatory adjustments are needed with respect to SFPP's 2002 recorded operating expenses in order to provide a reasonable projection of the operating expenses likely to be incurred by SFPP in 2003 and beyond: (1) an adjustment to reflect cash expenditures relating to environmental remediation and litigation costs associated with California-jurisdictional facilities rather than reserve accruals that were reflected in 2002 recorded expenses; and (2) an adjustment to reflect costs associated with the dismantlement of the pipeline facilities upon the ultimate termination of SFPP's services.[107] It is only the latter of the two recommended adjustments to operating expenses, i.e. the so-called DR&R expense adjustment, that has been contested by Indicated Shippers.

The recommended inclusion of a dismantlement, removal and restoration ("DR&R") provision in SFPP's cost of service is intended to provide SFPP with the means to collect funds for transportation- related costs that would not be incurred until after the ultimate

[106] Ex. 105A; Turner at 12.
[107] Ex. 104A; Turner at 10.

termination of SFPP services – by definition, a time in which any funds needed to actually remove the facilities could not be collected from shippers.

The DR&R provision is different from the cost of removing an old line for a line replacement. It is not a cost whose recovery can be reflected as depreciation of a replacement line. When SFPP replaces a pipeline, such as is underway on the Concord to Sacramento segment, it is not discontinuing the associated transportation service. Any costs SFPP incurs in removing the old line are rolled into the ultimate cost of the replacement line. Since the service is not discontinued and SFPP would continue to collect a tariff on that service, SFPP has the opportunity to recover its removal costs through its tariff. However, when SFPP ceases operations and its services are discontinued, SFPP would not be collecting any tariffs and any cost of subsequently removing the pipelines and restoring the sites would go unrecovered without a current DR&R provision.[108]

Based upon an engineering analysis of the cost of dismantling and removing its California-jurisdictional facilities, SFPP arrived at a DR&R estimate of $47.2 million in current dollars. Using the useful remaining life based on SFPP's California net book plant of 23.58 years, and an estimated inflation rate of 2.85%, this $47.2 million has a future value of $89.1 million in the year 2025. However, SFPP would have 24 years to collect these funds as a provision in its tariff rates. Based upon an assumption that SFPP could earn 5 percent interest on the accumulated provision balance collected, SFPP has adjusted its test year cost of service by $1.42 million ($1.4 million for SFPP's Application 2002 cost of service presentation), reflecting

[108] Ex. 104A; Turner at 12.

the annual amount sufficient, as accumulated over time, to allow recovery by SFPP of costs of dismantling and removing its pipeline facilities and restoring related property.[109]

Indicated Shippers contest the validity of SFPP's DR&R provision and recommend that DR&R costs be completely eliminated, thereby reducing SFPP's test year expenses by approximately $1.2 million.[110] The Indicated Shippers fail, however, to provide any supportable reason for excluding DR&R costs from SFPP's cost of service. Indeed, their purported rationale directly conflicts with sound regulatory precedent and principles.

In discharging regulatory obligations similar to those undertaken by the CPUC with respect to intrastate pipelines, the FERC has recognized on numerous occasions the inclusion of a DR&R component in a pipeline's cost of service to compensate the company for the estimated future costs associated with the retirement of its facilities.[111] The cost of performing these activities is a cost of doing business, which under regulatory principles, pipelines are entitled to recover from the shippers that benefit from the services. Excluding the DR&R component would violate this regulatory principle because it would essentially require SFPP to bear a portion of the cost of providing service.

The witness for Indicated Shippers has, as he must, conceded this fundamental point:

> Q. Let's assume there is a pipeline that needs to be abandoned. Who should be responsible for the cost of dismantle[ment] and removal after the last barrel has been shipped: the oil pipeline or the shippers?
>
> A. Under a hypothetical where we're dismantling a pipeline that has been providing service, an so therefore, the entity is going to...bear a cost

---

[109] *Id.* at 11.

[110] Ex. 105A; Turner at 6.

[111] See e.g., Enbridge Pipelines (KPC), 102 FERC ¶ 61,310 (2003); Kuparuk Transportation Co., 55 FERC ¶ 61,122 (1991); Endicott Pipeline Company, 55 FERC ¶ 63,028 (1991); White Shoal Pipeline Corp., 38 FERC ¶ 62,287 (1987).

> associated with dismantlement, you would want that to be recovered from the shippers.[112]

The Indicated Shippers' witness has now expressly acknowledged that dismantlement and removal expenses are properly recovered from shippers and that they should be included in cost of service. With this admission, the Indicated Shippers' challenge to SFPP's DR&R provision dies. As set forth below, the three reasons for eliminating SFPP's proposed DR&R provision advanced by Indicated Shippers in their prepared testimony cannot breathe life into Indicated Shippers' now moribund opposition.

a. Illegitimacy of the argument that SFPP is not incurring DR&R expense at this time:

Indicated Shippers claim that recording a DR&R expense in its financial records is a requirement for including a DR&R provision in an oil pipeline company's regulatory cost of service.[113] This claim is wrong.

It is true that SFPP does not record DR&R on its books. In order to record a DR&R provision for financial accounting purposes, there must be a legal obligation to dismantle and remove those assets, and the company must be able to reasonably estimate the fair value of the associated liability.[114]

However, no legal obligation is required to properly include a DR&R provision in a regulatory cost of service. Even the FERC recently stated that it "is aware that a number of oil pipelines are currently collecting an allowance in jurisdictional rates to cover the future cost of retiring and removing facilities referred to as a dismantling, removal and restoration (DR&R)

---

[112] Tr. Vol. 4; O'Loughlin at 476, lns. 4-13.

[113] Ex. 200A; O'Loughlin at 12.

[114] See Financial Accounting Standards Statement (FAS) No. 143, Accounting for Asset Retirement Obligations, issued in June 2001.

allowance. The Commission believes that these DR&R allowances do not necessarily reflect the existence of a legal obligation for the retirement of long-lived assets."[115]

As to the reasonableness of estimating the fair value of the liability, Indicated Shippers again confuse requirements for financial accounting purposes with requirements for regulatory cost of service purposes.[116] That is, in order to record a future obligation, or liability, for financial accounting purposes, the amount of the future obligation will not be recognized until a reasonable estimate can be made. For regulatory cost of service purposes, however, there is a different requirement. Since there is a high probability that SFPP will incur costs associated with the retirement of facilities in the future, it is appropriate for each barrel of oil moving through the pipeline, from now until termination date, to bear its fair share of these estimated future costs. The Indicated Shippers' approach of excluding a provision until such time costs are actually incurred has been refuted by the FERC, ruling that a "wait-and-see, all-or-nothing approach to DR&R is unreasonable and cannot be adopted."[117]

Indicated Shippers further criticize inclusion of a DR&R provision on the basis that it is inconsistent with past SFPP's actions treating anticipated operating expenses on a cash basis (as costs were incurred).[118] It is true that for certain expenses where SFPP in the past has established a reserve provision by expensing the total estimated cost of an obligation at that time, SFPP has adjusted expenses to reflect the periodic cash costs of those obligations as they are incurred.[119] That same treatment for DR&R, however, is impossible. By definition, a DR&R

[115] Notice of Proposed Rulemaking, "Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations, FERC Stats. & Regs., Proposed Regulations, ¶ 62,565 at p.65 (Oct. 30, 2002).

[116] Ex. 200A; O'Loughlin at 13.

[117] Endicott Pipeline Company, 55 FERC ¶ 63,028, at p. 65,162 (1991)

[118] Ex. 200A; O'Loughlin at 12.

[119] Ex. 105A; Turner at 8-9.

provision relates to *future* costs because DR&R is not performed until after facilities are removed from service. Accordingly, this argument is nothing but a variation of the claim that a pipeline can never recover DR&R costs, which is inconsistent with the admissions of Indicated Shippers' own witness.

b. The relevant time period is not just when SFPP ceases operation:

Indicated Shippers argue that SFPP's calculation of the DR&R expense is questionable and overstated because it is based on the remaining life of the pipe as opposed to the expected termination date of SFPP's business.[120] Of course, no one knows with certainty when SFPP will terminate services for a particular system. It is quite reasonable to expect that service will terminate at some point in time and that SFPP will be required to expend funds to perform DR&R. In a regulatory proceeding such as this, it is quite common for a regulatory agency like the CPUC to have to make reasonable judgments or forecasts based upon the information available. That a judgment is premised upon probabilities or approximations does not make it suspect or unreasonable. SFPP's DR&R calculation is based on the system-wide remaining life which is determined by depreciation rates approved by the FERC, which SFPP believes is the most reasonable proxy for the ultimate termination of SFPP services.

Indicated Shippers imply that having an external fund for the retention of the DR&R proceeds should be a requirement for including a DR&R provision in cost of service, asserting that without an external fund cash flow generated from the DR&R component of SFPP's revenues will be paid out to KMEP unitholders in the form of distributions, and thus will not be available when ultimately needed.[121] This is yet another baseless argument ignoring the

[120] Ex. 200A; O'Loughlin at 13.
[121] *Id.*

fact that KMEP is ultimately responsible for funding all of SFPP's operational costs, including DR&R. Without a DR&R provision in SFPP's cost of service, KMEP would not only be responsible for the funding, but would inappropriately bear the ultimate cost of DR&R. The FERC has addressed this issue and has not required the establishment of an external fund. The FERC has concluded that the pipeline company or its owners will remain ultimately liable in the event accumulated DR&R funds are not used for their intended purpose.[122]

8. <u>SFPP's Test Year Estimate of Throughput Volumes Is Reasonable</u>.

SFPP's 2003 test year showing reflects a 6% decrease in gasoline throughput. The explanation for the anticipated decline in volumes transported through SFPP's pipelines is straightforward. The projected decrease in volumes from year 2002 to the 2003 test year reflects the State of California's elimination of MTBE from gasoline. Because the MTBE-substitute, ethanol, cannot be transported by pipeline, this factor alone will result in an approximate 6% reduction in gasoline volumes transported through SFPP's intrastate pipelines.[123]

In addition to this 6% reduction in actual transported pipeline product, SFPP's 2003 TY forecast of throughput anticipated changes by major customers in their distribution sources from SFPP pipeline destinations to shipper-owned terminals located in some cases closer in on SFPP pipelines and in other cases located on customer-owned competing pipelines, further diverting revenue from SFPP pipelines.[124] For example, the forecast reflected throughput

---

[122] <u>See</u> e.g., Kuparuk Transportation Co., 55 FERC ¶ 61,122, at p. 61,382 (1991).

[123] SFPP's witness acknowledged at hearing that all indications suggest that volumes moving on the SFPP system are likely to be blended with ethanol at 5.7 percent, rather than 6 percent. (<u>See</u> Tr. Vol. 1; Morgan at 82). Consequently, the anticipated reduction in test period throughput may reasonably be estimated at 5.7% rather than 6%. Reduction of SFPP's test year throughput by 5.7%, rather than 6%, would, in turn, increase SFPP's test year projection of revenues by about $500,000.

[124] Ex. 104A; Turner; Schedule 10.

reductions expected to result from movement by a major shipper of 300,000 bbls/month of gasoline from SFPP's Sacramento pipeline to its own proprietary pipeline. It has subsequently told SFPP that it plans to move a small amount of diesel from its proprietary pipeline to SFPP. Because diesel is a heavier product, this action will slow down SFPP's pipeline while allowing the shipper additional capacity in its pipeline for moving gasoline.[125] Another shipper closed its South San Francisco terminal in early 2003, and as a result SFPP lost 2.9 million barrels per year that were previously delivered to the Oakland Airport Terminal, with ultimate delivery to a shippers' terminal at South San Francisco.[126]

The fact that, since September 11, 2001, SFPP continued to lose transport volumes into San Francisco International Airport, also contributed to the overall decrease in forecasted SFPP total intrastate system throughput. The SARS epidemic in 2003 further decreased the demand for commercial jet volumes at San Francisco International Airport—SFPP's largest location where jet fuel is delivered.[127] Military volumes were also anticipated to be down throughout SFPP's system during the test year. In the first quarter 2003, SFPP military volumes were 15.6% below the same period in 2002.[128]

Indicated Shippers propose to increase the volumes and related revenues to be considered in SFPP's TY 2003 cost-of-service analysis by using volumes for the period July 2002 through June 2003 rather than the decrease in 2003 test year volumes recommended by SFPP.[129] Using unadjusted 2002 volumes as part of test year volumes, as Indicated Shippers

---

[125] Ex. 100A; Morgan at 3; <u>also</u> Ex. 104A; Turner; Schedule 10.
[126] Ex. 100A; Morgan at 3.
[127] Tr. Vol. 1; Morgan at 100.
[128] Ex. 100A; Morgan at 3.
[129] Ex. 200A; O'Loughlin at 18.

propose, ignores reality by failing to adequately take into account the State of California's elimination of MTBE from gasoline. Since the full impact of the elimination of MTBE from California gasoline did not occur until December of 2003, Indicated Shippers clearly fail to capture the effects of the conversion.

This action by the state clearly will result in a decrease in volumes transported on SFPP's system; and it is inappropriate to rely in any fashion on recorded 2002 results which do not reflect in any fashion changes in gasoline formulation which directly affect SFPP's transportation volumes. As a matter of ratemaking policy, the Commission judges the reasonableness of rates based upon forecasted – not recorded – costs. Furthermore, reliance on actual volumes for the first half of 2003 overstates SFPP volumes by failing to capture the full effect of the switch from MBTE to ethanol. In fact, SFPP began the elimination of MTBE in gasoline in November of 2003 for complete elimination of MTBE at gasoline terminals on its system by December 1, 2003.[130] Thus, only with the December 2003 volumes is the elimination of MTBE fully realized.

Indicated Shippers make other assertions with respect to SFPP's development of test year volumes that are also inaccurate: (1) Indicated Shippers improperly rely on data from published KMEP regulatory filings and a California Energy Commission ("CEC") report to suggest that SFPP's intrastate volume growth is to be expected; and (2) Indicated Shippers compare test year volumes to actual-to-date (Jan – Jun) 2003 volumes at certain facilities and improperly draws conclusions from that analysis.

Indicated Shippers reference KMEP's 2002 10-K as evidence that SFPP intrastate volume growth is to be expected. The KMEP's 2002 10-K does state that due to the switch to

[130] Tr. Vol. 1; Morgan at 83.

ethanol there will be a small reduction in gasoline volumes. When considered in the context of total volumes handled by the entire Kinder Morgan petroleum pipeline system, the state-mandated switch to ethanol will admittedly result in only a proportionately small reduction in volumes. This "admission," however, neither contradicts nor undermines SFPP's testimony that the state-mandated switch to ethanol is likely to result, at a minimum, in an approximate 6% reduction in actual transported gasoline on SFPP's intrastate system.

Furthermore, Indicated Shippers rely upon a CEC report as evidence that SFPP intrastate volumes will grow.[131] Regardless of the questionable validity of this comparison, as described in SFPP Ex. 105A at 25-26, Indicated Shippers misapplied the data included in the CEC report. For example, the CEC data relied upon by Indicated Shippers forecasts demand for gasoline used in motor vehicles, which include both gasoline and any gasoline additives (e.g., MTBE or ethanol), rather than gasoline that can be transported by pipeline. Relying upon this data, which does not take into consideration the mandated switch from MTBE to ethanol, is inappropriate and leads to false suggestions of projected volume growth.[132]

When appropriately developing test year volumes, it is quite reasonable to expect that volumes at some locations will differ from test year projections, but that as a whole, system-wide volumes will be reasonably projected. Indicated Shippers specifically examine two facilities, and from this highly selective and extremely limited analysis, question the overall reasonableness of SFPP's test year volumes.

The examination is limited to volumes delivered to San Diego Harbor and Richmond. Indicated Shippers cite the large increase at San Diego Harbor, but fail to notice (or

[131] Ex. 200A; O'Loughlin at 16.
[132] Ex. 105A; Turner at 27-28.

mention) that there is an even larger decrease in Mission Valley volumes. As for the comparison of actual versus projected volumes at Richmond, it is important to note that SFPP deliveries to terminals at Richmond are different from typical truck loading terminals to which SFPP delivers. Some of the Richmond terminals have tanker loading/unloading facilities making deliveries at Richmond fluctuate significantly due to marine activity in and out of the Bay Area. SFPP deliveries to the Richmond area thus become a function of the refiner's response to supply and demand. Therefore, drawing conclusions about the SFPP CPUC-jurisdictional system from a comparison of Richmond volumes for the first six months of 2002 and 2003 is not reasonable.

9. The Reasonableness of SFPP's Forward-Going Rates On a Cost-of-Service Basis Is Further Validated by Consideration of the *UNOCAP* Factors.

In Resolution O-0043, the Commission indicated its intention to consider SFPP's existing intrastate rates under a current cost-of-service standard for purposes of evaluating the reasonableness of electric rate surcharge revenues collected by SFPP from the date of issuance of Resolution O-0043. The ALJ Scoping Memo confirmed that the purpose of the proceeding is to allow the Commission to develop a Test Year 2003 revenue requirement for SFPP (to be effective January 1, 2004) and to compare that revenue requirement to SFPP rates in order to determine the reasonableness of the electric surcharge rate increase.

In Resolution O-0043, the Commission also indicated that a cost-of-service showing may be useful in deciding whether SFPP should base its rates on market factors.[133] SFPP submits that the converse is also true: a market-based showing is useful to the Commission in deciding what type of cost-of-service analysis should apply to SFPP for purposes of this proceeding.

[133] Resolution O-0043, mimeo. at 8.

While the Commission has made quite clear its intention in this proceeding to rely on cost of service to measure the reasonableness of SFPP's electric surcharge, it has not prejudged any issues regarding the appropriate form, content, or type of cost-of-service methodology to be applied in evaluating SFPP's rates. The Commission, for example, has never suggested that cost-of-service methodologies and policies that it has developed in the context of its regulation of monopoly providers of essential services, like gas, electric, and telephone, are equally applicable "across-the-board" to a competitive provider of non-essential utility services, such as SFPP. In other words, it is critical for the Commission to recognize and give consideration to unique, competitive features of SFPP's operations that differentiate SFPP from utilities subject to traditional Commission cost-of-service rate regulation. In that context, it will be seen that the Commission, in evaluating the reasonableness of SFPP's electric surcharge, should adopt a more flexible, less rigid, and less-punitive cost-of-service approach than that proposed by Indicated Shippers.

To put it mildly, SFPP is not like the electric or gas distribution monopolies. As such, it is neither necessary nor appropriate to simply apply to SFPP the same cost-of-service methodologies and policies applied by the Commission to the monopoly utilities. It would seem to go without saying that SFPP should not be subject to more rigid cost-of-service regulation than that afforded to the electric and gas monopolies, yet Indicated Shippers' proposals to deny a tax allowance to SFPP and the North Line ratebase addition would accomplish that extreme end.

The ways in which SFPP differs from the monopoly utilities are as numerous as they are obvious. While SFPP provides very important and useful transportation services, such services are not "essential" as that term has been defined to refer to critical services, like electricity, gas, and water, that the public simply cannot do without.

While PG&E and Edison provide essential services to all segments of the public, from the small residential customer to the large industrial user, SFPP's principal customers are sophisticated oil producers with substantial financial resources. A few customers make up the majority of SFPP's sales and these customers have the resources and experience to counterbalance any potential exercise of market power by SFPP. For SFPP's ten biggest (by volume) destination terminals in California, the top five customers delivered over 90 percent of the product at three terminals, over 70 percent at three terminals, over 60 percent at three terminals, and over 50 percent at one terminal. SFPP's top customers, during the relevant time period, were BP, ChevronTexaco, ConocoPhillips, RoyalDutch/Shell, and Valero as well as other large, integrated refining companies.[134]

While the monopoly utilities provide essential service to captive customers who have no option but to take service from the utilities, SFPP's customers have myriad alternatives to SFPP, including trucks, vessels, and proprietary pipelines, as well as the financial capability and technical ability to avoid use of SFPP's system.[135]

PG&E or gas company customers are not in a position to threaten to exit the system in order to gain concessions. By way of contrast, the large, integrated oil producers provide very significant shares of SFPP's shipments. For example, according to recent SFPP shipment data, in each of the following cases, a single oil company controls the referenced percentage of total volumes shipped on SFPP's system: (1) 69 percent of shipments on SFPP's system in San Diego; (2) 38 percent of shipments into Sacramento; (3) 30 percent into Colton; (4) 20 percent into Stockton; and (5) 80 percent of shipments into San Francisco International

[134] Ex. 106A; Cox at 24-25.
[135] *Id.* at 24-26.

Airport. In some areas, these large shippers are likely to exercise a certain degree of buying market power, or monopsony power.[136]

While the electric and gas utilities have no constraints on the rates they can charge other than those imposed by the Commission, SFPP faces external, competitive pressures that limit the amounts that it can charge on certain segments of its pipeline system. The Commission can determine a cost of service rate for various services provided by the electric and gas utilities and be assured that the utilities can collect such rates from their customers. SFPP would not, however, have similar assurances that it could collect all of its cost-based rates, particularly if the cost-of-service rate exceeded the cost of alternatives available to SFPP's shippers.

The electric and gas monopoly utilities undergo periodic rate review (typically on a three-year cycle) in which capital additions can be recognized. The subject rate proceeding constitutes SFPP's first general rate case review in over twelve years. Nor does SFPP have any schedule, requirement or expectation regarding the timing of its next general rate case filing. Yet, pipelines by their nature are capital intensive, requiring large initial investment to accommodate their design capacity. Subsequent capacity expansions require much smaller investments, typically for additional pump capacity. Thus pipeline companies can experience extreme variability in investment over an extended period of years – with no regular or periodic rate review process designed to incorporate such additions in utility rates.

So given all of these distinctions between SFPP and regulated monopoly utilities, what facts or what possible rationale or policy basis could possibly justify subjecting SFPP to the same level – or an even stricter form – of cost of service than that applied to the monopoly utilities? SFPP has only raised its rates once in twelve years and that rate surcharge reflects

---

[136] *Id.*

well-documented and dramatic increases in electricity costs resulting from California's recent energy crisis. In fact, SFPP rates have fallen in real terms. Its tariff increases have been considerably less than would be required just to keep up with the overall level of economy-wide inflation.[137]

Rates charged by SFPP have no appreciable impact upon the price of a gallon of gas sold to the customer at the gas pump and represent only a small fraction of the delivered price of gasoline, typically less than one penny per gallon.[138] Indeed, if SFPP were forced to reduce its rates by 10%, any related decrease in the cost of gas at the pump would be less than one-tenth of one cent.[139]

The existing rates charged by SFPP to its shippers compare favorably with other pipeline rates. SFPP's detailed comparison of rates charge in a sample of tariffed pipeline segments operated by other pipeline companies with the rates charged by SFPP on its intrastate pipeline system demonstrate the comparability of SFPP rates to those charged in other locations.[140] Furthermore, a compilation of rates charged for pipeline services in the Los Angeles Basin by GATX, ARCO, Shell/Equilon and others reveals that rates were generally higher than the rates charged by SFPP for similar services.[141]

If shippers do not like the rates charged by SFPP, they can readily turn to alternatives, particularly with regard to movements within the local refining region. The Indicated Shippers themselves acknowledge the complexity and sophistication of the oil product

---

[137] Ex. 106A; Cox at 35.
[138] Ex. 106A; Cox at 36; <u>also</u> Tr. Vol. 4; O'Loughlin at 455.
[139] Tr. Vol. 4; O'Loughlin at 455.
[140] Ex. 106A; Cox at 34.
[141] *Id.* at 36.

distribution system in California, including the wide variety of alternatives to SFPP service that are available to shippers.[142] They admit that product from refineries located in a local refining region[143] can reach end customers also located within the refining region without ever being transported in an SFPP intrastate common carrier pipeline.[144] They admit that product can be moved between refineries without using SFPP's pipelines as can product from refineries to harbor facilities in Los Angeles.[145] They admit that even if SFPP's <u>entire</u> system were taken out of service, the oil companies could keep gasoline flowing to all customers in the local refining region as well as to some small portion of customers located outside of the local refining region.[146] They admit that oil producers can bypass SFPP by use of exchange agreements, a common practice in the industry, and through access to proprietary pipelines.[147] The witness for Indicated Shippers admitted awareness of Shell's statements to the effect that use of a unit train is an alternative to use of SFPP's line currently used to move product from Bakersfield to Los Angeles.[148]

Perhaps the most striking admission by Indicated Shippers of the freedom enjoyed by shippers to avail themselves of services other than those provided by SFPP is as follows:

> Q. Is it your testimony that trucks are an alternative to use of SFPP's pipelines for delivery of refined petroleum products to market destinations when it is in the oil company's economic interest to do so?

---

[142] Tr. Vol. 4; Watson at 437-439.

[143] By "local refining region," the witness for Indicated Shippers stated that she meant "an area that encompasses both the hardware facilities where products are brought into the state, and the refineries themselves, and the terminals that service the local area. With respect to the Los Angeles "local refining region," the witness defined it as "Los Angeles and contiguous counties there." (<u>See</u> Tr. Vol. 4; Watson at 440).

[144] Tr. Vol. 4; Watson at 441.

[145] Tr. Vol. 4; Watson at 442.

[146] Tr. Vol. 4; Watson at 441.

[147] Tr. Vol. 4; Watson at 444.

[148] Tr. Vol. 4; Watson at 445.

A. I believe there are other factors besides strict economics that influence those decisions, but generally, yes.[149]

The above-referenced litany of facts, circumstances, and conditions clearly differentiate SFPP from the gas and electric monopolies and just as certainly support the conclusion that the same cost-of-service regulation designed for gas and electric utilities should not be applied indiscriminately to SFPP. Yet, that is exactly what the Indicated Shippers would have the Commission do – and, in some cases, like tax allowances, have the Commission apply even more severe standards to SFPP than are applied to the monopoly utilities.

To justify an arbitrary decrease in rates that currently compare favorably with other pipeline rates, Indicated Shippers must recommend application of what can only be characterized as radical cost of service adjustments. Their tax allowance recommendation is unprecedented, punitive, and discriminatory and presumes regulatory treatment for SFPP that is harsher than that afforded to the Commission's other cost-of-service regulated utilities. Their proposed denial of the North Line rate base addition would have the Commission treat SFPP worse than the monopoly utilities regulated by the Commission and, contrary to law, would constrain the definition of "test period" to reflect only a calendar year. Their proposed adjustments to SFPP's capital structure, cost of debt, and cost of equity are not representative of anticipated future conditions, are analytically deficient, and based upon improper factual comparisons. Their suggested adjustments to SFPP's overhead allocations are arbitrary and admittedly unsupported by any factual analysis of actual overhead costs and accepted methodologies for allocating such costs. Their recommended adjustment to fuel and power expenses would inappropriately freeze SFPP's costs at 2002 recorded levels and is based upon a

[149] Tr. Vol. 4; Watson at 450, lns. 3-8.

complete misunderstanding of the nature of power expenses that SFPP is likely to incur during the test period. Similarly, in relying on the average of data as old as five years, Indicated Shippers fail to reflect likely expenses to be incurred by SFPP with respect to accounting for oil losses/shortages. Indicated Shippers admit that DR&R expenses are a proper element of SFPP's cost of service that should be recovered from shippers. Finally, Indicated Shippers ignore the real-world effect of the mandated switch from MTBE to ethanol upon SFPP's test period volumes, choosing instead to rely on irrelevant data to support an unjustifiable increase in SFPP's expected throughput.

C. No Portion of Any Rates Collected by SFPP for Services Related to Its Watson Station and Sepulveda Facilities Is Unreasonable or Otherwise Subject to Refund.

There are two distinct time periods that are relevant in the context of the Commission's review of the reasonableness of charges that SFPP has assessed with respect to its Watson Station and Sepulveda facilities and related services, i.e. the period prior to January 1, 2004 and the period subsequent to January 1, 2004. With respect to such charges assessed up to and until December 31, 2003, the Commission standard for reviewing the reasonableness of the charges for Watson Station and Sepulveda will be based upon its existing ratemaking policy applicable to pipeline corporations, like SFPP, including consideration of the so-called *UNOCAP* factors. With respect to charges for Watson Station and Sepulveda assessed on or after January 1, 2004, the Commission standard for reviewing reasonableness will principally depend on application of the 2003 TY cost of service adopted by the Commission in this proceeding.

As set forth more specifically below, SFPP submits that its rates for Watson Station and Sepulveda (i) for the period through December 31, 2003 are reasonable under the Commission's ratemaking policies applicable to oil pipeline corporations; and (ii) for the period from January 1, 2004 are reasonable when considered in the context of SFPP's 2003 TY cost of service.

1. The Rates Charged by SFPP for Services Related to Watson Station and Sepulveda Facilities for the Period Through December 31, 2003 Are Reasonable.

The ALJ Scoping Memo in A. 03-012-017 establishes a 2003 TY cost of service analysis as the basis for determining the reasonableness of electricity surcharges collected by SFPP from October 24, 2002. The ALJ Scoping Memo by its terms does not address the issue of the reasonableness of the rates charged by SFPP for services related to its Watson Station and Sepulveda facilities, much less establish any standard for reviewing the reasonableness of such rates. Thus, to determine the applicable standard of review, we must look to existing Commission policy regarding ratemaking treatment for oil pipeline corporations like SFPP.

In determining the reasonableness of the rates of an oil pipeline corporation like SFPP, the Commission does not rely simply upon a cost of service standard of review. As a matter of fact, in *Re Investigation Into Possible Over-Assessment by State Board of Equalization*, the Commission dismissed oil pipelines and other utilities from the proceeding on the basis that they "are not subject to cost-of-service [or] rate base rate-of-return regulation."[150]

The nature and scope of Commission ratemaking vis-à-vis oil pipeline corporations is most directly addressed in *City of Long Beach v. Unocal California Pipeline Company*, 66 CPUC2d 28 ("*UNOCAP*"), in which the Commission initially considered and determined the just and reasonable rates applicable to specific public utility pipeline transportation services, as is the case here with respect to the rates for Watson Station and Sepulveda. In the *UNOCAP* case, the Commission stated the following:

---

[150] D.93-07-047, mimeo. at 6.

> The reasonableness of rates is determined as matter of fact based on the totality of the circumstances surrounding the service provided by a specific utility. In this proceeding, parties have attempted to establish or deny the reasonableness of Unocap's rates by invoking either traditional cost of service rate methods or by justifying the departure from such methods and the adoption of market based rates. We may determine that Unocap's initial tariff rates may be based upon market rates, rather than traditional cost of service ratemaking, which uses original cost less depreciation to establish rate base, upon a showing that there are practical alternatives to particular services offered by Unocap such that its initial rates are subject to market discipline...[151]

As expressly acknowledged in the Commission order on rehearing of its *UNOCAP* decision, there is no statutory requirement that cost-of-service based pricing be used for all utilities across-the-board. The Commission is free to determine that SFPP's initial tariff rates for Watson Station and Sepulveda "may be based upon market rates, rather than traditional cost of service ratemaking..."[152] In explaining that reliance on market-based factors rather than cost of service is a more appropriate form of rate regulation for oil pipelines, the Commission specifically recognized the importance of the distinction between captive" ratepayers and large sophisticated customers, a distinction that is entirely apt in the subject case:

> One of the more noticeable characteristics of this case is the nature of its central issue: a dispute between oil producers and oil pipeline companies over the allocation of transportation costs. Since our decision will not affect the price refineries pay for oil, ordinary Californians will see no change in the price of refined products. It is also true that no law or regulation prevents any competitor from attempting to serve Unocap's customers.[153]

The Commission has expressly identified the factors that it will consider in determining the reasonableness of the jurisdictional rates to be charged by a pipeline utility, like SFPP, including the following: (1) whether the pipeline's principal customers are sophisticated

---

[151] 54 CPUC2d 422, at 432.
[152] 66 CPUC2d 28, at 31.
[153] *Id.* at 33.

oil producers; (2) whether the pipeline faces potential competition from new pipelines; (3) whether shippers have reasonable alternatives, such as shipment by truck, vessel or proprietary pipeline; (4) whether the pipeline's proposed rates compare favorably to other pipeline rates; and (5) whether the pipeline's proposed rates provide for an acceptable rate of return when analyzed under a cost-of-service approach.[154]

The oil companies are not captive customers; they are large and sophisticated business entities; they have alternatives to SFPP's services. There may be no two better candidates for market-based regulation than the Watson Station and Sepulveda services. Both services were provided to oil company shippers by SFPP as an accommodation. Furthermore, to the extent that the oil companies believe the rate for either Watson Station or Sepulveda to be excessive, there are viable, economic alternatives available to them. They simply are not "captive customers" of SFPP. As shown in further detail below, given the oil companies' size and sophistication as well as their many economically viable options for moving their refined products to market, it is simply the height of arrogance and greed for the oil companies to continue to press their case with the Commission for a cost of service rate for Watson Station and Sepulveda.

a. Market conditions, including the availability of sufficient competitive alternatives, support a Commission finding that 5¢/bbl. is a reasonable rate for Line 109 (the "Sepulveda" line).[155]

Suppliers and shippers in the Los Angeles basin can and do readily and economically move their product to market without any need to use the Sepulveda line. There are numerous methods by which the refiners that make petroleum products in the origin market

---

[154] *Id.* at 31.

[155] All record references in Section III.C. of the subject brief relate to the record in C. 97-04-025 and accurately reflect the facts as they existed at the time the case was heard.

can bypass the Sepulveda Pipeline. In fact, Line Section 109 is little more than a 3.8-mile length of pipe in the midst of a spaghetti bowl of pipe in the center of a huge hub of industrial, petroleum refining, and transportation activity in the Los Angeles basin.[156]

Within the refining and petroleum product transportation industries, the Sepulveda line serves a rather limited role. It connects a manifold at Sepulveda Junction to the Watson Station connection point to the SFPP mainline pipelines. The Sepulveda Junction manifold is located at the edge of the GATX Terminals Corporation ("GATX") Carson terminal, adjacent to the Texaco/Equilon and ARCO refineries. The Texaco/Equilon Refinery has direct access to the Sepulveda Junction origin point. The Ultramar Refinery has access to the Sepulveda Line through GATX.[157]

If anything, the assertion that the Sepulveda line operates in the midst of a complex and active market for refined petroleum products is a considerable understatement. Six major refineries operate in the Los Angeles basin, two connected directly to Sepulveda Junction. These two are the Texaco/Equilon Refinery and Ultramar Refinery. The other four are the ARCO, Mobil, Chevron, and Tosco (formerly Unocal) refineries. All four of the latter refineries ship product into SFPP's Watson Station via proprietary lines. These proprietary lines include ARCO's 16-inch line from its Carson refinery, Chevron's 20-inch line from its El Segundo refinery, Mobil's 12-inch line from its Torrance refinery, and Tosco's 20-inch line from its Wilmington refinery. The fact that these lines are proprietary does not, of course, mean that access to or use of them is restricted to the owner of the pipeline.

---

[156] See e.g., SFPP Ex. 202(R), Attachment 1; SFPP Ex. 209(R), Attachment 4.

[157] SFPP Ex. 209(R) at 48; SFPP Ex. 209R is the source support for the various factual assertions regarding alternatives to service on the Sepulveda line.

Other companies that also own and operate significant transportation and storage systems within the Los Angeles basis pipeline network include GATX, ARCO Terminal Services Corporation ("ATSC"), and Equilon. GATX owns and operates a tank farm and terminal facility nearby and upstream of Sepulveda Junction in Carson, which provides services to various third parties. GATX's Carson terminal is connected via reversible lines to most of the refineries in the Los Angeles basin, to the origin of the Sepulveda Line, and to the harbor as well. GATX also maintains truck-loading facilities. ATSC operates a terminal at East Hynes in Los Angeles which is connected to the SFPP mainline system as well as to the ARCO, Mobil, Texaco-Equilon, Tosco, and Ultramar refineries. ATSC also has numerous reversible pipelines in the neighborhood of Sepulveda Junction, which connect to, among other locations, Signal Hill, East Hynes, another entry point to the SFPP interstate and intrastate pipelines, and to the harbor as well. An important component of the Equilon system is its terminal located in Carson, next to SFPP's Watson Station and just three miles from Sepulveda Junction. The Equilon Terminal, along with its direct 16-inch pipeline connection to Watson Station, is also directly connected with the Texaco/Equilon, Ultramar, and Tosco refineries and GATX.

The two refineries located in the origin market which are connected to Line 109, Texaco/Equilon and Ultramar, can access at least two other downstream entry points to the SFPP main-line pipelines without having to use GATX or Line Section 109. The Texaco/Equilon refinery is now directly connected to the Shell/Equilon Carson Terminal via Equilon's 12-inch Line 28 while the Ultramar refinery is directly connected to the Shell/Equilon Carson Terminal by Equilon's 18-inch Line 25. Once product is shipped via these alternative pipelines to the Shell/Equilon Carson Terminal, it can enter SFPP's main-line pipelines at Watson Station, which bypasses Line Section 109. Both refiners can also reach ATSC's East Hynes facility, which is downstream of both Line Section 109 and Watson Station, by shipping their product on ATSC pipelines. The use of either the Watson Station or the East Hynes access to SFPP's main-line pipelines bypasses not only all of the costs associated with using Line Section 109 but also the costs of using the GATX facilities.

Many other alternatives exist for bypassing Line Section 109, including those that do not make use of SFPP's downstream mainline pipelines. Texaco/Equilon and Ultramar each have their own berths at Long Beach and Los Angeles Harbors with proprietary pipelines connecting those berths to their refineries. As previously noted, these two refineries are connected to the GATX Carson terminal, the Equilon Carson terminal, and ATSC's pipeline system, and these three terminalling and transportation companies themselves have extensive marine facilities.

Most notably, these refineries can and do truck products to local markets. Trucking from the Ultramar, Texaco/Equilon, and GATX truck racks has served markets both near and distant, including truck deliveries from these three facilities to gas stations in Los Angeles and in the counties of Orange and Ventura, and to a lesser extent San Bernardino, Riverside, and San Diego. Other trucking alternatives for suppliers/shippers to move product to market without using Line 109 include: shipping jet fuel to local airports and delivering product to the harbor for shipping to other markets.

The evidence is overwhelming that alternatives available to customers of Line Section 109 in the Sepulveda Junction origin market are sufficient to prevent SFPP from raising its rate on Line Section 109 above the competitive level without losing substantial business. .

In fact, over the years, volumes on Line Section 109 have declined by more than half as suppliers and shippers have used the alternatives in question to bypass Line Section 109.

In 1996, Watson Station received 109.1 million barrels in the aggregate out of the five other lines and 34.3 million barrels out of Line Section 109 (representing less than 24 percent of total deliveries of product into Watson Station). In 1999, the total throughput on Line Section 109 has declined to 14.7 million barrels, which represents less than 10% of the 154.5 million barrels supplied through Watson Station during 1999.

This decrease in use of the Sepulveda line (as well as the variability of the refiners' use of Line 109) is compelling evidence that refiners whose products currently move through Line Section 109 can and do dispose of their production elsewhere. Such evidence further demonstrates the real-world availability of the alternatives as well as the absence of market power. The Commission should therefore endorse and authorize SFPP's market-based rate of 5¢/bbl. for use of the Sepulveda Pipeline in transporting refined petroleum products within California.

In evaluating the reasonableness of a rate, the Commission has indicated that it will also consider: (1) whether the pipeline's principal customers are sophisticated oil producers; (2) whether the pipeline faces potential competition from new pipelines; (3) whether the pipeline's proposed rates compare favorably to other pipeline rates; and (4) whether the pipeline's proposed rates provide for an acceptable rate of return when analyzed under a cost-of-service approach.[158]

The only SFPP customers who are contesting the 5¢/bbl. rate for Line 109 service are ARCO, Mobil, Texaco, and (perhaps) Ultramar. There can be no dispute that these customers of the pipeline are large and sophisticated users of the pipeline service, possessing

[158] 66 CPUC2d 28, at 31.

clear options to terminate use of Line 109 or retaliate in other ways against an attempt by the pipeline to exercise market power.

There are also opportunities for the conversion of existing crude or idle pipelines into competitive alternatives within a reasonable period of time. The Sepulveda-Carson area is interlaced with a large number of crude lines, creating significant possibilities for conversion and interconnection to divert barrels around Line 109. There can be little dispute that a segment of pipe already sitting in the ground is a potential low-cost component of an alternative delivery path, whether or not it runs precisely from the Sepulveda area to a point on the SFPP system.

The record also reflects unrebutted testimony demonstrating that the 5¢/bbl. rate for Line 109 service, when compared to charges for similar movements, reflects a competitive price. The average price charged by Shell/Equilon for its 14 tariffed product pipelines in California was 0.7 cents per barrel-mile. The three shortest pipelines in the sample, with an average length of about 12 miles, had an average tariff of 1.2 cents per barrel-mile. The average price charged for a random sample of 30 product pipelines regulated by FERC was 1.4 cents per barrel-mile. By comparison, the rate charged by SFPP for use of its Sepulveda line is 1.3 cents per barrel-mile (5.0 cents divided by 3.8 miles = 1.3 cents per barrel-mile).[159] Unrebutted testimony demonstrates that the rate charged by SFPP for use of its Sepulveda line is comfortably in the range of rates charged by other pipelines in California and across the entire United States.

Finally, the record reflects an empirical analysis of market power and concentration that entirely validates the common-sense conclusion that SFPP's rate for use of Line 109 is subject to market discipline given the various, competitive alternatives available to

[159] SFPP Ex. 209(R) at 54-55.

suppliers and shippers for transporting product from Sepulveda Junction to market destinations within and without the Los Angeles basin.

b. The 3.2¢/bbl. Watson Station Volume Deficiency Charge is reasonable.

To comply with SFPP's tariff rules and regulations, shippers must meet a specified minimum incoming pumping rate. As outgoing volumes at SFPP's Watson Station have grown, the minimum pumping rate into Watson Station has increased over the years. When confronted with increased pumping rates dictated by pipeline operations, refiners and terminal operators - who as shippers must meet the required, higher pumping rate - typically solve the problem by installing new pumps and larger diameter pipelines to allow for a faster pumping rate.[160]

In 1989, after completion of a major West Line expansion program, SFPP requested all product suppliers (refiners/terminal operators) to increase incoming pumping rates from 10,000 barrels/hour to 15,000 barrels/hour. Rather than installing their own new pumps and/or larger diameter pipelines, several refiners asked SFPP to consider an alternative for the suppliers to meet the 15,000 barrels/hour incoming gasoline rates.

SFPP undertook additional analyses to determine if there were alternatives to alleviate or reduce the cost to suppliers associated with the required increase in the incoming pumping rates. SFPP determined that if the incoming tankage could be operated on a "drain dry" basis, the efficiency of the suppliers' gathering facilities would be improved and therefore the incoming pumping rate increase could be deferred until a later date. (Previously, tanks could only be utilized for a specific grade of gasoline, because a minimum volume of product had to be

[160] SFPP Ex. 202(R) at 11; SFPP Ex. 202(R) is the source document for all factual assertions relating to the history and development of the Watson Station Volume Deficiency Charge..

maintained in each gasoline tank to avoid discharging vapors to the air when a tank was emptied and refilled.). By installing a vapor handling system and connecting it to each tank, SFPP was able to utilize each tank for a variety of products, since the installed system captured vapors that would otherwise be emitted to the atmosphere. In turn, the use of tanks for multiple product grades effectively expanded the operating capacity of Watson Station, thereby providing an effective substitute for higher incoming pumping rates.

Operationally, SFPP would have preferred supplier compliance with the required, higher incoming pumping rate. Notwithstanding this preference, SFPP specifically undertook to install the vapor recovery system at Watson Station at the request and based upon the commitments of four suppliers, three of whom agreed to pay for use of the "drain dry" system at a rate of up to 5¢/bbl. while another customer committed to pay up to 4¢/bbl. Based upon extensive negotiations with its shippers and after installation of the new system and commencement of operations in 1991, SFPP charged for services related to the Watson Station vapor recovery system at a rate of 3.2¢/bbl.

Since the inception of SFPP's pipeline system, the incoming supply into tankage at Watson Station has been the shipper's responsibility. SFPP has on several occasions requested its shippers to increase their respective pumping rates into Watson. The shippers have complied, either through the installation of additional pumps or through installation of larger diameter gathering lines. SFPP's installation of the referenced vapor handling system did nothing more than provide shippers with another alternative.

No shipper is forced to pay for use of SFPP's Watson Station vapor recovery system. Each shipper is free to make its own determination as to whether it will use the "slow pumper" facilities or increase its pumping rate by investing in additional pumps or larger gathering lines or use other terminal facilities. Any customer can avoid payment to SFPP of a charge for use of the vapor recovery system simply by installing facilities (pumps/larger diameter pipeline) that would allow the customer to meet the required 15,000 bbl/hr incoming pumping rate at Watson Station. Each shipper presumably will select the most economic choice that is ultimately in its own best interest. To the extent shippers continue to use SFPP's Watson Station vapor recovery system and have not expended capital in order to bypass use of the system, it is reasonable to assume that these shippers have made an economic determination that their capital is better deployed elsewhere.

The fact that suppliers and shippers have made their choice was first memorialized by contract and subsequently by shippers' continuing use of the Watson Station vapor recovery facilities in lieu of increasing incoming pumping rates. The 3.2¢/bbl. rate was set by the terms of contracts freely and fairly negotiated between SFPP and its suppliers. SFPP submits that the freely negotiated, arms' length agreements setting 3.2¢/bbl. as the Watson Station facilities' rate are themselves a definitive indication that the 3.2¢/bbl. rate is both market-based and competitive

Nevertheless, applying the same standards established by the *UNOCAP* decision for evaluating the reasonableness of a tariff rate initially proposed by a pipeline corporation, it can independently and readily be demonstrated that 3.2¢/bbl. is indeed a reasonable rate for intrastate use of SFPP's Watson Station vapor recovery system for the period through December 31, 2003.

The Commission has specifically indicated that it will consider a market-based approach to setting rates for pipeline companies under appropriate circumstances. The Commission has further explained that it focuses on whether there is sufficient competition for the services that the utility is offering to warrant relaxation of its more traditional form of cost-based rate regulation.[161] The evidence in the subject proceeding demonstrates the ready availability of alternatives whereby by shippers can avoid payment of charges for use of SFPP's Watson Station vapor recovery system and, correspondingly, that SFPP's rate for such services is subject to market discipline.

Any company wishing to avoid the slow pumper fee at Watson Station can do so by building the facilities necessary to meet the required, higher pumping rate into Watson Station. This could be done by either the individual refiners or by one of the companies that holds itself out to provide terminalling and pipeline services. Indeed, the shippers' own testimony provides evidence of the feasibility of just such an option. Equilon could construct facilities to meet the required Watson Station incoming rate at a cost below the existing rate charged by SFPP for use of its vapor recovery system, while it would be more expensive for other companies to provide faster pumping.[162]

If a refiner makes the determination to expend its capital for purposes other than construction of faster pumping facilities, there are, of course, further alternatives for such refiners or terminal operators to avoid payment of the Watson Station slow pumper fee. These refiners and terminaling operators have various alternatives for getting product to market that do not require transportation through Watson Station and payment for use of SFPP's vapor recovery system. Watson Station is hardly a bottleneck or monopoly facility through which all supply in the LA basin has to move in order to reach destination markets.

---

[161] 65 CPUC2d 613, 632.
[162] Tr. Vol. 9; Cox at 1064 and1067.

Refiners can avoid Watson Station and the slow pumper fee by delivering product at East Hynes, a terminal owned by ATSC, that is connected to SFPP's main-lines downstream of Watson Station. ATSC's East Hynes facility is connected to most refineries and the harbor by pipelines and is also connected to the Equilon and GATX terminals.[163] East Hynes is most certainly a viable alternative to Watson Station.[164]

Refiners can also avoid use of Watson Station and payment of the slow pumper fee by directly trucking product from the refineries to customers. Purchasers of product in some destinations served by SFPP in Orange and San Bernardino Counties could receive product trucked directly from refineries or from terminals that they own or that are operated by third party teminalling operations. The evidence shows that significant volumes of gasoline are already loaded on to trucks at racks located at the refineries or at terminals in the Los Angeles area. Other product is delivered in the Los Angeles area after first being shipped to SFPP delivery points of Colton and Orange.[165]

Evidence that refiners have the option to construct their own fast pumper facilities and evidence of the alternatives available to refiners to avoid use of Watson Station - including access to SFPP's mainline system via ATSC's East Hynes facility and the option to truck product directly to customers - all serves to prove there is sufficient competition to justify a market-based rate of 3.2¢/bbl. for use of SFPP's vapor recovery system.

---

[163] SFPP Ex. 209(R) at 95.

[164] It must be remembered for purposes of a "market power" analysis, that the alternative of East Hynes does not have to be capable of diverting the entire volume of product otherwise moved through Watson Station (in excess of 150 million barrels in 1999) in order to impose pressure on the price charged for use of the vapor recovery system. Testimony demonstrates that shippers could frustrate an attempt by SFPP to raise its price by .5¢/bbl. by diverting to East Hynes and by raising the pumping rate on 21 million barrels or about 14% of the volumes delivered to Watson Station in 1999.

[165] SFPP Ex. 209(R) at 96.

The refiners and terminal operators that use Watson Station and incur the slow pumper fee include Equilon, GATX, Texaco, Tosco, Chevron, ARCO, Mobil Needless to say, such large and sophisticated companies do not require Commission intervention to insulate them from the consequences of any determination made by any of these companies to eschew available alternatives and to continue their use of SFPP's Watson Station facilities.

As for the potential introduction of new pipelines to compete with SFPP's Watson Station facilities, the record shows quite clearly that Equilon can economically construct facilities that would allow it to avoid payment of the slow pumper fee. It also demonstrates that Chevron has built a new spur from its line to Watson that terminates in the Equilon terminal facility. It appears that Chevron volumes can now be diverted into the Equilon facility with Equilon doing the final delivery into Watson.[166] If Equilon were to choose to construct facilities to avoid payment of what it perceives to be an excessive slow pumper fee, Chevron supplies when combined with Equilon supplies for delivery to Watson would constitute a significant volume that would be avoiding the slow pumper fee.

With regard to a cost-of-service analysis of the rate-of-return that SFPP would enjoy if allowed to charge 3.2¢/bbl. for its slow pumper fee, SFPP undertook no such study. The slow pumper fee has never been a cost-of-service rate nor is there any Commission requirement that it be cost-based. SFPP contests the validity of cost-of-service as any measure of the reasonableness of a rate that has been set by arms' length, negotiated agreement and that has been tendered by it for initial Commission approval as market-based.

In Decision No. 96-04-056 issued April 10, 1996 in the "Application of Pacific Pipeline System," the Commission authorized a market-based tariff and rate methodology for the

---

[166] Tr. Vol. 9; Cox at 1064 and 1067.

pipeline transportation service.[167] In doing so, the Commission noted, approvingly, the following characterization of the appropriate approach the Commission should take in determining whether to authorize a market-based rate:

> The standard approach to determine whether market-based rates are appropriate for public utilities is to determine whether there is sufficient competition for the services that the utility is offering to warrant a relaxation of the rules establishing rates for those services based on the utility's historical costs, including the return on and of capital invested. Regulators frequently examine whether the firm in question has "market power." (65 CPUC2d 613, 632).

The Commission then explained how the question of "market power" is typically evaluated by regulatory bodies and affirmed that the Commission, in deciding whether more light-handed rate regulation is appropriate, relies upon the exact type of empirical analysis of market power that SFPP undertook and presented with respect to SFPP's Watson Station facilities.[168] <u>By contrast, the complaining shippers have presented nothing to the Commission that remotely resembles any analysis of "market power" based upon the "standard procedures" endorsed by this Commission for making such evaluations</u>. In essence, SFPP's market power analysis stands unrebutted.

SFPP's expert explained how he derived market share and the HHI calculation for the Watson Station origin market. The resulting HHI is rather low, 1841, well below the 2500 initial screen recommended by the Department of Justice and used by this Commission and the FERC. It is also very similar to all other HHIs calculated by SFPP's expert during this proceeding.[169]

---

[167] 65 CPUC2d 613.

[168] 65 CPUC2d 613, 632.

[169] The detailed calculation of the Watson Station origin market HHI is found in Attachment 22 to Ex. 209(R).

Consistent with Commission standards, SFPP's expert has examined whether SFPP will be able to exercise market power in the Watson Station origin market and has shown that SFPP lacks market power in the defined origin market. The Commission should conclude, as it did in Pacific Pipeline, that the pipeline's lack of market power is sufficient justification to authorize market-based rates for services provided by the pipeline, including vapor recovery services provided by SFPP at Watson Station.[170]

2. Rates Charged by SFPP for Services Related to Watson Station and Sepulveda Facilities for the Period From January 1, 2004 Forward Are Reasonable.

As set forth in detail in Section III.B above, SFPP's 2003 TY cost-of-service showing, including all revenues related to the rates for services involving the Watson Station and Sepulveda facilities, demonstrates that SFPP's test period cost of service exceeds its test period revenue by approximately $14.6 million.[171] Evidence that SFPP is underearning its cost of service demonstrates that rates charged by SFPP with respect to Watson Station and Sepulveda for the period January 1, 2004 and beyond are justified and therefore reasonable.

IV. CONCLUSION

Commission resolution of A. 03-02-027 and related matters will resolve all issues pending in C. 97-04-025, C. 00-04-013, and A. 03-02-027. The specific issues to be resolved are as follows:

(1) Whether electricity surcharge revenues collected by SFPP between October 24, 2002 and January 1, 2004 are reasonable (whether evaluated under traditional reasonableness review standards or in the context of a 2003 TY cost of service);

(2) Whether electricity surcharge revenues collected by SFPP subsequent to January 1, 2004 are reasonable in the context of a 2003 TY cost of service;

[170] 65 CPUC2d 613, 633.

[171] Exhibit 104A; Turner at 18.

(3) Whether SFPP's systemwide rates, including rates related to its electricity surcharge and its Watson Station and Sepulveda facilities, for the period January 1, 2004 and beyond are reasonable based upon a 2003 TY cost of service.

(4) Whether charges for Watson Station and Sepulveda services collected by SFPP prior to January 1, 2004 are reasonable under the Commission's ratemaking policies applicable to oil pipeline corporations; and

(5) Whether charges for Watson Station and Sepulveda services collected by SFPP subsequent to January 1, 2004 are reasonable in the context of a 2003 TY cost of service.

For all of the reasons set forth herein, SFPP believes that each of the above-referenced questions must be answered in the affirmative. Accordingly, SFPP asks the Commission to issue its order determining that, for all relevant time periods covered by the subject proceedings, SFPP's overall, systemwide rates as well as the individual rate components at issue, have been and remain reasonable.

Respectfully submitted this 26th day of April, 2007 at San Francisco, California.

GOODIN, MACBRIDE, SQUERI, DAY & LAMPREY, LLP
James D. Squeri
505 Sansome Street, Suite 900
San Francisco, California 94111
Telephone: (415) 392-7900
Facsimile: (415) 398-4321
E-Mail: jsqueri@goodinmacbride.com

By *_/s/ James D. Squeri_*
James D. Squeri

Attorneys for SFPP, L.P.

2539/001/X88542.v1

ATTACHMENT A

FERC Policy Statement On Income Tax Allowances

LEXSEE 111 FERC 61139

Inquiry Regarding Income Tax Allowances

Docket No. PL05-5-000

FEDERAL ENERGY REGULATORY COMMISSION - COMMISSION

111 F.E.R.C. P61,139; 2005 FERC LEXIS 1129

POLICY STATEMENT ON INCOME TAX ALLOWANCES

May 4, 2005

PANEL:

Before Commissioners: Pat Wood, III, Chairman; Nora Mead Brownell, Joseph T. Kelliher, and Suedeen G. Kelly

OPINION:
[*61,736]

1. On December 2, 2004, the Commission issued a notice of inquiry regarding income tax allowances. The Commission asked interested parties to comment when, if ever, it is appropriate to provide an income tax allowance for partnerships or similar pass-through entities that hold interests in a regulated public utility. The Commission concludes that such an allowance should be permitted on all partnership interests, or similar legal interests, if the owner of that interest has an actual or potential income tax liability on the public utility income earned through the interest. This order serves the public because it allows rate recovery of the income tax liability attributable to regulated utility income, facilitates investment in public utility assets, and assures just and reasonable rates.

I. Background

2. The instant proceeding was initiated by the Commission in response to the U.S. Court of Appeals for the District of Columbia remand in *BP West Coast Products, LLC, v. FERC,* n1 in which the court held that the Commission had not justified the so-called *Lakehead* policy regarding the eligibility of partnerships for income tax allowances. The *Lakehead* case n2 held that a limited partnership would be permitted to include an income tax allowance in its rates equal to the proportion of its limited partnership interests owned by corporate partners, but could not include a tax allowance for its partnership interests that were not owned by corporations. Prior to *Lakehead,* the Commission's policy provided a limited partnership with an income tax allowance for all of its partnership interests, but did so in the context that most partnerships were owned by corporations. This ruling was not appealed until a series of orders involving SFPP, L.P. in the proceedings underlying the remand. n3 The Commission's rationales for permitting a tax allowance for corporate partner interests were (1) the double taxation of corporate earnings, (2) the equalization of returns between different types

of publicly held interests, *i.e.* the stock of the corporate partner (which involves two layers of taxation of partnership earnings) and the limited partnership interests (which involve only one), and (3) encouraging capital formation and investment.

n1 *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004) (*BP West Coast*), *reh'g denied*, 2004 U.S. App. LEXIS 20976-98 (2004).

n2 *Lakehead Pipe Line Company, L.P.,* 71 FERC P 61,388 (1995), *reh'g denied*, 75 FERC P 61,181 (1996) (*Lakehead*).

n3 *Opinion No. 435* (86 FERC P 61,022 (1999)), *Opinion No. 435-A* (91 FERC P 61,135 (2000)), *Opinion No. 435-B* (96 FERC P 61,281 (2001)), and an *Order on Clarification and Rehearing* (97 FERC P 61,138 (2001)) (collectively the Opinion No. 435 orders.) These are now pending before the Commission on remand and rehearing in Docket Nos. OR92-8-000, *et al.,* and OR96-2-000, *et al.*, respectively.

3. The court found all of these rationales unconvincing. First, the court rejected the double taxation rationale in *Lakehead*, concluding that (1) only the costs of the regulated entity may be recovered, and (2) taxes are but one cost paid by a corporate partner as part of its cost of doing business. n4 The court also rejected the rationale that the investor should be able to obtain the same returns without regard to which instrument the investor purchases. The court rejected this argument by noting that if any income tax allowance is provided, this benefits all investors holding instruments proportionately because the additional income is shared on a *pro rata* basis. n5 Given this *pro rata* distribution of income by the partnership, the court concluded that non-corporate partners would receive an excess rate of return.

n4 *BP West Coast* at 1288.

n5 *Id.* at 1292-93.

4. Thus, while the double taxation function may affect the eventual return for the investor, the court made clear that this is a function of corporate structure and the attendant tax consequences, not the regulated utility's risk. n6 The court therefore concluded that the investor's return and risk are no more appropriately attributed to the regulated entity than are the investor's various costs in determining the costs or allowances that the regulated entity is permitted to recover.

n6 In making a decision whether to buy a limited partnership interest (where only the unit holder's income is taxed), or a share of a corporate partner (where the corporate income is taxed as well), it should be the individual investor that makes the adjustment for the double taxation. The individual investor can do this by paying prices that equalize the pre-tax return to the investor of the different instruments that have income derived from the same public utility assets.

[*61,737]
5. The court also rejected the Commission's third rationale that an income tax allowance should be permitted to encourage capital to flow into public utility industries regulated by the Commission. n7 Throughout its analysis the court stated that the Commission's central assumption in its *Lakehead* decisions was that income taxes are an identifiable cost for the regulated entity. Thus, if a partnership paid no income taxes, or had no potential income tax liability, no cost was incurred and therefore an income tax allowance would reimburse the entity for a phantom cost. Accordingly, the court concluded that a payment for a non-existent cost was still invalid even if designed to encourage needed infra-structure investment.

n7 *BP West Coast.* at 1292-93.

6. While the court's decision addressed only the Order No. 435 opinions, it became apparent that the remand has implications for other proceedings and regulated utilities as well. As was discussed in the more recent *Trans-Elect* order, n8 denying a tax allowance would significantly reduce the expected returns that were the basis for the investment in that project. In light of the broader implications of *BP West Coast,* the Commission sought comments here on whether the court's ruling applies only to the specific facts of the SFPP, L.P. proceeding, or also extends to other capital structures involving partnerships and other forms of pass-through ownership. The Commission asked whether the court's reasoning should apply to partnerships in which: (1) all the partnership interests are owned by investors without intermediary levels of ownership; (2) the only intermediary ownership is a general partnership; (3) all the partnership interests are owned by corporations; and (4) the corporate ownership of the partnership interests is minimal, such as a one percent general partnership interest of a master limited partnership. The Commission also asked if (1) the court's decision precludes an income tax allowance for a partnership or other ownership interests under any of these situations, will this result in insufficient incentives for investment in energy infrastructure; (2) or will the same amount of investment occur through other ownership arrangements; and (3) are there other methods of earning an adequate return that are not dependent on the tax implications of a particular capital structure?

n8 *Trans-Elect NTS Path 15, LLC*, 109 FERC P 61,249 (2004) (*Trans-Elect*).

II. <u>Comments</u>

7. After an extension of the comment period to January 21, 2005, thirty-three comments were timely filed with an additional nine comments filed late. As enumerated below in greater detail, the

comments advocate four general positions. While no party argues for the continuation of the *Lakehead* doctrine in its current form, three appear to argue that an approach should be used to preserve the tax allowances now available to certain limited liability corporations (LLCs), or possibly provide a justification for tax allowances for all partnerships and LLCs, as long as there is no additional cost to the rate payers beyond that which would have been incurred through a corporate form. Three commentors argue for granting a tax allowance if a partnership is entirely owned by a tax paying corporation filing a consolidated return. Ten argue that the tax allowance should be granted only to entities that actually pay taxes and that there should be no allowance for "phantom" taxes. Twenty-four commentors would provide a tax allowance to all entities to assure that tax factors do not control the selection of the investment vehicle. Two filings were limited to interventions or minor comments and are not discussed further in this order. n9

n9 Edison Mission Energy, which urged that the income tax allowance issue be resolved quickly, and Piedmont Natural Gas Company, Inc., which only intervened.

A. Proposals Akin to *Lakehead*

8. Three commentors expressed concern about the possible impact of the court's decision on existing public utility partnerships that include for-profit private and non-profit public electric utilities. n10 These concerns are summarized by Wisconsin Public Power Inc. (WPPI), which asserts that the Commission should permit LLCs and partnerships to have an income allowance if the LLC demonstrates that its structure would not increase the income tax component of the cost of service to transmission rate payers. WPPI is a part owner of the American Transmission Company, LLC (ATCLLC), which owns transmission lines conveyed to it by various utilities, private and public, in Wisconsin. To maintain cash flow neutrality for its owners after the facilities were transferred to ATCLLC, ATCLLC was provided a tax allowance equal to the blended tax rate of its owners. Thus, to the extent that the income stream to a private owner would be taxed at 35 percent, ATCLLC was provided an allowance for taxes on that income. A municipality pays no taxes and therefore that portion of the income stream did not result in a tax allowance. The ATCLLC income stream is then allocated at the owner level in a way that prevents over or under-recovery.

n10 Electric Power Supply Association (EPSA); Michigan Electric Transmission Company, LLC (METC); Wisconsin Public Power, Inc.

9. WPPI states that this arrangement assured that the income stream from transmission operations would not be taxed at the operating level of ATCLLC, thus retaining the two tier structure that existed before the various private companies divested their transmission assets to ATCLLC. These two historical taxation tiers were the corporate income tax and the tax on the shareholder dividends. ATLLC states that without the use of the LLC form, and a tax allowance attributable to the utility income stream, the private shareholders **[*61,738]** would suffer a loss in value because of the additional level of taxation on transmission income. Thus, the value of a transmission interest in ATCLLC would be diminished below the value it had for the private corporation before the transfer of the asset. For this reason the private companies would not have transferred their assets to

ATCLLC. WPPI therefore concludes that the tax allowance on the income stream of LCC that pays no income taxes itself was essential to the creation of an independent transmission system on the upper Michigan peninsula.

10. METC likewise requests a solution that would preserve the rate attributes historically extended to LLCs, consistent with the methodology first announced in the *Lakehead* cases. Most importantly, METC asserts that the Commission should take no action that would undermine existing investments in independent transmission companies that are LLCs. Thus, METC's concerns do not turn on the preservation of the *Lakehead* doctrine as such, but that the corporate shareholders of that LLC are not deprived of the tax allowance that was built into the rates of return on the transmission assets that these firms contributed to METC's independently owned transmission system.

11. EPSA urges that the Commission affirm the *Lakehead* philosophy by providing the Court of Appeals with a better rationale. EPSA suggests that there are six basic options available to the Commission. One is to give utilities organized as corporations a tax allowance, but not partnerships. A second is to treat partnerships and corporations the same and give both a tax allowance. A third is to deny any partnerships with non-corporate owners a tax allowance but permit the allowance for partnerships owned wholly by corporations. A fourth is to readopt *Lakehead*. A fifth is to eliminate the allowance and base rates on pre-tax rates of return. A sixth is to decide matters of partnership income tax allowances on a case-by-base basis.

12. EPSA states that first option would have a serious negative consequence on raising capital for the industry, particularly with regard to large projects with multiple owners. It notes that even if corporate-owned partnerships could reorganize to qualify for a tax allowance, there are additional administrative costs that would be passed on to consumers. It further asserts that a case-by-case approach would result in uncertainty and to disqualify a partnership based on a single non-corporate partner seems unfair and hard to justify analytically. Determining returns on a pre-tax basis is likely to be controversial and difficult to implement.

13. EPSA therefore concludes that the only realistic options are (1) treating all entities the same; or (2) a continuation of the Commission's *Lakehead* policy. ESPA notes that taxes are an imputed cost based on public utility net income. As such, EPSA claims that the court ignored the fact that taxes are imputed to a utility in situations where the utility pays no actual taxes because the corporate income tax allowance is based on the regulatory book income of the utility in question. EPSA's analysis assumes that the required rate of return is 12 percent. EPSA then asserts that in the absence of a tax allowance, a utility subject to the 35 percent corporate income tax would only pay out dividends equivalent to 7.8 percent net income (instead of 12 percent).

14. EPSA states that in contrast, the corporate tax allowance increases the utility's pre-tax return on equity to 18.5 percent, which after application of the 35 percent tax rate, results in the 12 percent equity return. EPSA concludes that if an allowance is not allowed to partnerships owned by one or more corporations, the amount returned to the parent corporation will not be sufficient to attract equity investment. Since EPSA opposes an income tax allowance for pass-through entities that are not owned by a corporation, and believes it unfair to deny an income tax allowance if some of the partnership interests are not owned by a corporation, it concludes that the *Lakehead* approach should be affirmed.

B. <u>If a Corporation Owns the Partnership Interests</u>

15. Three commentors n11 argue that an income tax allowance should be allowed if the partnership interests are owned wholly by corporations filing a consolidated return. In support of this position, Kern River states that the Commission's stand alone rate-making policy should apply, just as it does in the case of a consolidated return that can be filed when a parent corporation owns at least 80 percent of a subsidiary's stock. n12 All three of these commenters assert that in the case of a regulated partnership held within a single corporation and whose income is included in a consolidated return, the income from the regulated partnership generates a tax liability that is included in the jurisdictional cost of service of the corporate group.

n11 Duke Energy Corporation; Kern River Gas Transmission Company (Kern River); Texas Gas Transmission, LLC.

n12 The stand-alone policy provides that income tax allowance of a corporate subsidiary should be determined based on the actual or potential income tax obligation of that subsidiary. Thus, the amount of the allowance is not based on the tax obligation of the parent company in the test year in which the consolidated return is filed. *See City of Charlottesville v. FERC*, 774 F.2d 1205 (D.C. Cir. 1985) (*City of Charlottesville).*

16. Kern River further states that there is no question that income generated by a partnership within a corporate group creates an income tax liability for the group. This is because, while the partnership is not taxed directly, its income is flowed through to the corporations that hold the partnership interests. Duke Energy further asserts that *BP West Coast* was not intended to invalidate **[*61,739]** an income tax allowance for pass-through entities owned by corporations and at a minimum that decision should be restricted to its facts. n13 Thus, regardless of the corporate structure, the income a partnership generates is a part of the consolidated group's taxable income, and therefore generates a corporate tax liability. These commenters therefore assert that a partnership that is wholly owned by a corporation should be granted an income tax allowance.

n13 Kern River at 7-8; Duke Energy at 4-5.

C. <u>Opposition to Any Allowance if Taxes are not Actually Paid</u>

17. Ten commentors assert that there should be no tax allowance for any entity that does not actually pay income taxes or has a potential liability for such taxes. n14 Only one such commentor, the NGSA, suggests that the court's ruling should be applied on a case-by-cases basis. All others assert that the court's holdings should be applied uniformly to all partnerships, LLCs, or similar pass-through entities, thus creating a single uniform rule. Thus, there would be no income tax allowance for any partnership or LLC, including those owned by corporations that do not have an actual or potential income tax liability. They assert that the court's decision is binding on the Commission, and that there should be no income tax allowance for partnerships that do not pay income taxes.

n14 Air Transport Association of America, Inc.; American Public Gas Association; BP West Coast Products; Calpine Corporation; Canadian Association of Petroleum Producers; Missouri Public Service Commission; Natural Gas Supply Association (NGSA); National Rural Electric Cooperative Association; Society for the Preservation of Oil Pipeline Shippers; and Valero Marketing and Supply Company.

18. They assert that any such phantom taxes will result in a significant increase in rates to customers or consumers. This is because the gross-up for the income tax allowance could result in as much as a 60 percent increase in the rate of return on equity assuming that the regulated entity is allowed a twelve percent rate of return on equity. n15 Any gross-up from the tax allowance represents an increase in return for entities that may be already charging unjust and unreasonable rates even if a tax allowance were excluded. Rather than provide an inflated return, they assert that any needed incentives for increased investment should be provided by special actions to increase the pre-tax rate of return. Given this alternative, denying a tax allowance will not act as a disincentive to investment in infra-structure facilities.

n15 *See* BP West Coast Products at 6; NGSA at 3.

19. In addition, BP West Coast Products asserts that the inquiry in Docket No. PL05-5-000 was prompted by *ex parte* communications to the Commission and therefore no determinations of any specific income tax issues should be made in this proceeding. It further asserts that the partners investing in SFPP's parent entities will rarely pay taxes on the income generated by that partnership and that many such master limited partnerships (MLP) are intended to act as tax shelters that remove cash from existing pipelines. BP West Coast Products concludes that providing MLPs an income tax allowance is not necessary to encourage new investment and that this should be done by providing an increased pre-tax rate of return

20. At bottom, these commentors base their argument on three central points in the *BP West Coast* opinion. The first is that "where there is no tax generated by the regulated entity, either standing alone or as part of a consolidated group, the regulator cannot create a phantom tax in order to create an allowance to pass-through to the rate payer." n16 The second is that it is not "the business of the Commission to create a tax liability where neither an actual nor estimated tax is ever going to be paid or incurred on the income of the utility in the rate making proceeding." n17 The third is even if an income tax allowance is necessary to implement a congressional mandate designed to encourage investment in public utility facilities, the court concluded was inadequate to create an allowance for fictitious taxes. n18

n16 *BP West Coast* at 1290.

n17 *Id.* at 1292.

n18 *Id.* at 1292-93.

D. Comments Supporting a Tax Allowance for All Entities

21. Twenty-four commentors n19 support a tax allowance for all entities investing in public utility enterprises. These commentors start from the premise that the court did not have before it the realities of partnership or LLC taxation and as such did not address them. These commenters thus believe there is no barrier to considering the issue of tax allowances for partnerships in light of the fuller record presented in this proceeding. In fact, some state that this proceeding is an opportunity to reconsider the Commission's *Lakehead* decision, which they believe was incorrect, and to **[*61,740]** return to the Commission's pre-*Lakehead* policies. In this regard, they conclude, contrary to the court's statement in *BP West Coast* and the Commission's *Lakehead* decision, income taxes are not like all other costs. Unlike operating expenses such as office supplies, rent, or wages, they argue that income taxes are imposed on, or imputed to, a public utility's income, and as such income taxes are not a cash deduction from operations. Because the income tax allowance is imputed, it is grossed-up on the utility's allowable dollar return rather than functioning as a charge against operating income. Thus, the income tax allowance is a function of the equity return, and in turn generates the cash flow that is used to pay the utility income taxes. n20

n19 Alaska Gas Transmission Company, LLC; American Gas Association (AGA); Association of Oil Pipe Lines (AOPL); American Transmission Company, LLC; Duke Energy Corporation; Edison Electric Institute and the Alliance of Energy Suppliers, filing jointly; Enbridge Inc. and Enbridge Energy Partnerships; Enterprise Products Partners, L.P.; Guardian Pipeline; Hardy Storage Company, LLC; INGAA; Interested Gas Pipeline Partnerships; Kaneb Pipe Line Operating Partnership, L.P.; Kayne Anderson Capital Advisors and Kayne Anderson MLP (Kayne); Kinder Morgan Interstate Gas Transmission, LLC, Trailblazer Pipeline Company, and Transcolorado Gas Transmission Company, filing jointly; MidAmerica Energy Company; Millennium Pipeline Company, L.P.; Plains Pipeline, L.P.; Publicly Traded Limited Partnerships; Northern Border Pipeline Company; Shell Pipeline Company, L.P.; Tortoise Energy Infrastructure Corporation; Trans-Elect, Inc.; Trans-Elect NTD Path 15, LLC; Wisconsin Electric Power Company and Edison Sault Electric Company, filing jointly; and WPS Resources Corporation (WPSR).

n20 Thus, for example, if gross revenues are $ 500, and operating expenses such as rent, fuel, labor, interest, repairs, and depreciation of $ 400 are charged against gross revenues, this would leave operating income of $ 100. Assuming this equals the allowed equity return, the corporate tax on this $ 100 would be $ 35. The $ 100 is therefore grossed up to approximately $ 154 to leave a $ 100 return after payment at an income tax rate of 35 percent. *See* Northern Border at 5 - 7 and 16; INGAA at 16.

22. Proceeding from the premise that income taxes are an imputed cost on income, these twenty-four commentors assert that whether the entity is a corporation or a partnership, there is an actual or potential income tax liability generated by utility income. In turn, it is utility income that generates the cash flow used to pay the income taxes. They claim that this is true whether the income tax is actually paid by a corporation as the first tier investor, or the partners of a partnership as the first-tier investors. They define a first tier investor is one that invested funds in assets that are generating the public utility income. These commentors stress that the critical point is that while a partnership owns the public utility assets, it is a flow-through entity whose income is taxed not at the partnership level, but is taxed to and paid by the individuals or entities that own the partnership interests.

23. Thus, they state that in the case of a partnership, the partners include the utility income in their income tax returns and the tax on utility income is paid at that point. n21 The tax on this income is paid whether or not cash distributions are made to the partners. In contrast, a corporation that owns a public utility asset is the taxpaying entity on the income generated by utility income. These commentors assert that, as with a partnership, the tax on this first tier income is paid whether or not dividends are paid to the corporation's shareholders. The commentors therefore assert that there is no phantom tax liability on partnership income. This is because the tax liability on utility income is real, but it is paid by the partners rather than by a corporation that functions as a separate taxpaying entity.

n21 The individual partner files a Form1040 tax return and pays the marginal individual tax rate on the utility income. The corporate partner files a Form 1120 tax return and pays the marginal corporate tax on the utility income. At the current time the maximum marginal tax rate in both cases is 35 percent. *See* EEI's comments at 10-11 for a concise summary of partnership tax law and filing procedures.

24. These commentors also start from the basic regulatory premise that a utility must earn a return comparable to that of investment opportunities of similar risk if it is to attract investment. n22 They state that concept refers to the after tax, not the pre-tax, return to the investor in the utility assets is the standard used in public utility rate making regardless of the form of the ownership. Thus, if the after tax return must be 12 percent to attract capital, then all first tier investors in the utility assets must have a reasonable opportunity to earn a 12 percent after tax return if the utility is to attract capital. If partnerships are not permitted a tax allowance on utility income, then cash will not be generated to pay the taxes due on that utility income, and the partnership form of ownership would not be competitive with the corporate form.

n22 *F.P.C. v. Hope Natural Gas,* 320 U.S. 591, 603 (1943).

25. These commentors also provide various numerical examples of how income tax returns would differ if partnerships are not provided a tax allowance. Assuming that $ 100 is the after tax return required return to attract capital, the court's decision would permit a tax allowance sufficient to

cover the 35 percent maximum corporate tax that would be paid on corporate income. The gross-up to achieve the after-tax return is about 54 percent and generates the cash flow to pay the tax. Thus, after the corporate income tax is paid, the after-tax return is $ 100. n23

n23 *See* INGAA at 16-17; EEI at 13-14; Northern Border at 3-5, 7-8.

26. If a partnership is permitted an income tax allowance, the result is the same because the maximum personal income tax allowance is also 35 percent. As with a corporation, the income tax allowance could provide the individual partners with the cash to pay the taxes on utility income, and therefore results in an after tax return of $ 100, the allowed regulatory return. However, if an income tax allowance is not allowed the partnership, then the partners must pay a $ 35 income tax on $ 100 of utility income, leaving them with only an after-tax return of $ 65. Therefore these commentors conclude that partnerships must be granted an income tax allowance to make the partnership and corporate business forms equally attractive because the tax implications are the same.

27. These commentors also explore some secondary tax factors to demonstrate the need for a partnership tax allowance if such entities are to be a competitive vehicle for investments. While taking some pains to avoid the double taxation issue discussed by the Court of Appeals, they point out **[*61,741]** that without an income tax allowance partnerships are not competitive with corporations for the individual investor who files a Form 1040 income tax return. As noted in the previous example, without a partnership income tax allowance, the after tax return to a corporate investor is $ 100 and to the partnership investor it is $ 65. Assuming that that the corporation pays out all $ 100 in dividends, the income tax for the Form 1040 individual investor is $ 15, with a resulting after tax return of $ 85.

28. Thus, they assert, for a Form 1040 individual investor who has the option of investing either in a corporation or partnership, the partnership is not competitive if, all other things being equal, there is no partnership tax allowance. Moreover, if a corporation owns less than 80 percent of a subsidiary corporation, the subsidiary's dividends are taxed. Pursuing the previous numerical example, if the ownership is greater than 20 percent or less than 80 percent, the 20 percent of the subsidiary's dividends are taxed, or a 7 percent tax differential at the 35 percent bracket. If the ownership is less than 20 percent, 30 percent of the subsidiary's dividends are taxed, or a 9.5 percent tax differential at the 35 percent rate. This increases the cost of participating in large projects in which risk sharing is a consideration.

29. These commentors also assert that there are other significant administrative and commercial advantages to partnerships beyond facilitating risk sharing. Benefits include the ability of some entities, such as municipalities or public transmission owners, to participate in partnerships, but not corporations, avoiding the expense involved in corporate charters, by-laws, shareholder meetings, and greater flexibility in making contributions in-kind and in distributing of earnings. They also argue that Congress clearly intended that utility firms were to be eligible for partnership treatment in order to encourage investment, and that the court's ruling undercuts this important purpose.

30. Finally, these commentors assert that numerous large public utility investments have been made in recent years relying on the tax allowance to provide part of the required after-tax return. n24 They note that as was discussed in the recent *Trans-Elect* order, n25 denying a tax allowance would significantly reduce the expected returns that were the basis for that badly needed investment. They provide lists of numerous publicly traded partnerships that have substantial amounts of equity, and assert that some of these partnerships have made significant additional investments in reliance on the income tax allowance. n26 For these reasons these commentors conclude that all entities investing in utility operations, and generating utility income, should be permitted an income tax allowance. As discussed in the WPPI and EEI comments, the size of the allowance would be determined by the weighted maximum tax rate of the partners involved. Any problems of over-or under recovery would be adjusted within the partnership structure to assure that the benefits of any income tax allowance would not flow to a partner that had no actual or potential income tax liability.

n24 These commentors include Algonquin Gas Transmission, LLC; Alliance Pipeline, L.P; ATLLC; East Tennessee Natural Gas, LLC; Egan Hub Partners, L.P.; Enbridge Pipeline; Horizon Pipeline Company, LLC; Great Lakes Natural Gas Pipeline; Green Banks Gas Pipeline, LLC; Gulfstream Natural Gas Pipeline; Iroquois Gas Transmission Company; Islander East Pipeline Co, LLC; Kinder Morgan Interstate Gas Transmission, LLC; Maritimes & Northeast Pipeline; Market Hub Partners, L.P.; METC; Moss Bluff Hub Partners, L.P; North Baja Pipeline LLC; Portland Natural Gas Transmission System; Texas East Gas Transmission, LLP; TransCanada Corporation; Trans-Elect ND-15; Tuscarora Gas Transmission Company; Saltville Gas Storage Company, L.L.C; and Shell Pipeline Company.

n25 *Trans-Elect NTS Path 15, LLC*, 109 FERC P 61,249 (2004) (*Trans-Elect*).

n26 *See* comments of: Duke Energy Corporation at 9-10, 30; Enbridge Inc and Enbridge Energy Partners at 4-5; Gas Pipeline Partnerships at 2-4; Millennium Pipeline Company, L.P. at 2; Northern Border Pipeline Company at Appendix A; Publicly Traded Partnerships at 13-14.

III. Discussion

31. The issue is under what circumstances, if any, an income tax allowance should be permitted on the public utility income earned by various public utilities regulated by the Commission. As stated earlier, while the court's decision in *BP West Coast* only addressed the particulars of a certain oil pipeline, the numerous comments submitted here indicate that partnerships or other pass-through entities are used pervasively in the gas pipeline and electric industries as well. Upon review of the comments, there appear to be four possible choices: (1) provide an income tax allowance only to corporations, but not partnerships; (2) give an income tax allowance to both corporations and partnerships; (3) permit an allowance for partnerships owned only by corporations; and (4) eliminate all income tax allowances and set rates based on a pre-tax rate of return.

32. Given these options, the Commission concludes that it should return to its pre-*Lakehead* policy and permit an income tax allowance for all entities or individuals owning public utility assets, provided that an entity or individual has an actual or potential income tax liability to be paid on that income from those assets. Thus a tax-paying corporation, a partnership, a limited liability corporation, or other pass-through entity would be permitted an income tax allowance on the income imputed to the corporation, or to the partners or the members of pass-through entities, provided that the corporation or the partners or the members, have an actual or potential income tax liability on that public utility income. Given this important qualification, any pass-through entity seeking an income tax allowance in a specific rate proceeding must establish that its partners or members have an actual or potential income tax **[*61,742]** obligation on the entity's public utility income. To the extent that any of the partners or members do not have such an actual or potential income tax obligation, the amount of any income tax allowance will be reduced accordingly to reflect the weighted income tax liability of the entity's partners or members. n27

n27 This is a technically complex issue that would be addressed in individual rate proceedings as suggested by EEI and WPPI.

33. In reaching this conclusion, the Commission expressly reverses the income tax allowance holdings of its earlier *Lakehead* orders. As stated in EEI's comments, *Lakehead* mistakenly focused on who pays the taxes rather than on the more fundamental cost allocation principle of what costs, including tax costs, are attributable to regulated service, and therefore properly included in a regulated cost of service. n28 Relying on *BP West Coast,* some commenters assert that because a pass-through entity pays no cash taxes itself, this results in a phantom tax on fictional public utility income. However, the comments summarized in sections A and D of Part II of this policy statement demonstrate that this assumption was incorrect. While the pass-through entity does not itself pay income taxes, the owners of a pass-through entity pay income taxes on the utility income generated by the assets they own via the device of the pass-through entity. n29 Therefore, the taxes paid by the owners of the pass-through entity are just as much a cost of acquiring and operating the assets of that entity as if the utility assets were owned by a corporation. The numerical examples discussed in sections A and D of Part II of this policy statement also establish that the return to the owners of pass-through entities will be reduced below that of a corporation investing in the same asset if such entities are not afforded an income tax allowance on their public utility income. n30

n28 EEI comments at 8. In support of this point several commenters cite to *City of Charlottesville*, *supra*, note 12, for the proposition that a tax cost involves real taxes but not necessarily require that cash taxes be paid by the regulated entity. *See* EEI at 11-13; INGAA at 12-13; Joint Comments of the Interested Gas Pipeline Partnerships at 10-12; AOPL at 8-9.

n29 The comments and numerical examples submitted by the EEI, INGAA, and Northern Border demonstrate that under partnership law the partners, or members, of pass-through entities pay taxes on the public utility income of the operating entities that they control through the partnership or other pass-through entity. *See* EEI at 13-15; INGAA at 15-17; Northern Border at 5-8; Shell Pipeline Company LP at 4; and WPS Resources at 14-16.

n30 The record suggests that there is a substantial amount of existing investment at issue in this proceeding. *See* Duke Energy at 2 (75 percent of $ 14.4 billion in energy infrastructure invested for the years 2001 through 2003 is in pass-through entities); Enbridge, Inc. at 4 (ownership interests in over 20,000 miles of crude oil, petroleum products, and natural gas pipelines); Enterprise Products Partners, L.P. at 1 (enterprise value of approximately $ 14 billion); Kaye Anderson at 1 (in excess of $ 1 billion in MLP equity); Publicly Traded Partnerships at 1-2, 13 (Figure 1 and text, market capitalization of publicly traded partnerships of $ 47.3 billion in 2004), and at 14, table of publicly traded partnerships owning and operating energy pipelines (market capital $ 38.5 billion.)

34. As several commentors point out, a detailed discussion of the realities of partnership tax practice was not before the court when it reviewed the Opinion No. 435 orders. Because public utility income of pass-through entities is attributed directly to the owners of such entities and the owners have an actual or potential income tax liability on that income, the Commission concludes that its rationale here does not violate the court's concern that the Commission had created a tax allowance to compensate for an income tax cost that is not actually paid by the regulated utility. As explained in detail by the comments summarized in sections A and D of Part II of this order, the reality is that just as a corporation has an actual or potential income tax liability on income from the first tier public utility assets it controls, so do the owners of a partnership or LLC on the first tier assets and income that they control by means of the pass-through entity.

35. The first tier income involves the investors in the pass-through entity holding the specific physical assets that are generating the public utility income that results in a potential or actual income tax liability. In the case of Trans-Elect, this would be the investment that the partnership made in the upgrade to the Path 15 transmission line in California. As discussed in *Trans-Elect, supra*, the owners of Trans-Elect NTD Path 15, LLC, are a Subchapter C corporation (PG&E) and one LLC, Trans-Elect, LLC. n31 If no income tax allowance is permitted on Trans-Elect NTD Path 15's public utility income, the return to the investing entities would be less than if PG&E had invested directly in the line.

n31 *Trans-Elect, supra, note 8, at PP 2-4.* Trans-Elect develops merchant transmission lines. Trans-Elect comments at 1-2.

36. As set forth in the previously cited examples provided in the comments discussed in section D of Part II of this policy statement, termination of the allowance would clearly act as a disincentive for the use of the partnership format for two reasons. First is the difference in the nominal return itself. The second is that the income taxes paid by two corporations investing in this situation would increase because one or both would not be able to benefit from the tax advantages of a consolidated income tax return. n32 It should be noted that if such first tier assets are owned only by Subchapter C corporations, their rates would include an income tax allowance designed to recover the 35 per-

cent maximum corporate marginal tax rate. n33 The same result obtains if **[*61,743]** the assets are owned by a partnership or an LLC that is in turn owned either by Subchapter C corporations or by individual investors.

n32 As discussed in the comments, if a Subchapter C corporation owns 80 percent or more of a subsidiary, there is no income tax paid by the subsidiary. All taxation is at the parent level through the use of a consolidated return. *See* Northern Border at 6-7 and 11-12; INGAA at 15-17.

n33 This analysis suggests that if partnerships and limited liability companies are not permitted to have an income tax allowance, there are strong incentives to shift to the taxable corporate ownership form. This could be done by converting a partnership to an LLC and then electing to have that entity taxed as a Subchapter C corporation. Once this was done, then the newly taxable entity, which would be operating the very same assets as it did as a pass-through entity, would be entitled to a 35 percent income tax allowance. *Cf.* AOPL at 9.

37. Thus, the policy the Commission is adopting should not result in increased costs to public utility ratepayers, and may actually reduce them if a partnership or LLC has a lower weighted marginal tax rate and fewer administrative expenses than the normal corporate ownership form. n34 The Commission therefore concludes that, as is argued by the commentors urging an income tax allowance for all public utility entities, providing an income tax allowance to partnerships in proportion to the interests owned by entities or individuals with an actual or potential income tax liability does not create a phantom income tax liability. The fact that some partnerships or LLCs may be used for financial investments rather than for making infrastructure investments does not warrant a different policy result here. n35 Moreover, the Commission emphasizes that the primary rationale for reaching the conclusion here is to recognize in the rates the actual or potential income tax liability ultimately attributable to regulated utility income. Having concluded that this will not result in phantom income taxes, it is then legitimate to conclude that the result here will facilitate important public utility investments such as that made by Trans-Elect NTD Path 15, LLC in the Path 15 upgrade.

n34 As discussed in the WPPI and EEI comments, if a partnership or LLC has municipal governments as some of the partners or LLC members, the tax allowance is reduced because municipalities and their operating entities have no actual or potential income tax liability on utility income.

n35 The partners of master limited partnerships have actual tax liability for any income recognized by the partnership. However, distributions may substantially exceed partnership book income. Such distributions do have an ultimate income tax liability depending on the status of the capital account of the individual partners. This matter can present complex allocation and timing issues that would be addressed in individual rate proceedings. However, a simple numerical example can illustrate the basic principles. For example, assume that an individual invests $ 100 in a partnership and obtains a ten percent interest in that partnership.

This establishes a partnership account (or basis) for the individual of $ 100. During year one of that investment the partnership has $ 100 in income before depreciation and depreciation of $ 70. The partnership therefore has net income of $ 30 and also makes a distribution of $ 100. Since the individual partner owns ten percent of the partnership, that partner must declare $ 3 in income on the individual's 1040 tax form, but does not pay taxes on the $ 10 distribution made to that partner.

The capital account of the individual partner is adjusted as follows. Ten percent of the partnership income before depreciations (or $ 10) is allocated to the individual partner and is added to that partner's account. Ten percent of the partnership depreciation, or $ 7, is deducted from the account, as is the cash distribution. The individual's partnership account therefore stands at $ 93 ($ 100 + $ 10 - $ 10 - $ 7). In year two the partnership income is zero and no distributions are made, so the individual's partnership account is unchanged. However, that individual partner sells the partnership interest for $ 105. This difference is taxable as follows. Since $ 7 of the sale price is a gain above the year 2 partnership account level of $ 93, it will be taxed as income. This results in a tax on the cash that was distributed in the prior year but for which no income tax was paid at that time. Depending on the nature of the depreciation taken, the $ 7 may be taxed as ordinary income through the operation of various recapture provisions. The additional $ 5 is also income and is also taxed, most likely at the capital gains rate since it is gain in excess of the partner's original capital investment of $ 100.

38. In retrospect, it was the Commission's failure to distinguish between first and second tier income that lead to the double taxation rationale that the Commission incorrectly advanced in *Lakehead*. Dividends paid to the common stock investor and by the corporate investor in a pass-through entity are second tier income to such a common stock investor. As such, an income tax is paid by the investor in addition to the corporate tax that is due on the first tier income. In contrast, first tier income flows either to the corporation, a corporate partner, or individual partners (or LLC members) and is taxed at that level. To the extent *Lakehead* either concluded or assumed that dividend payments and income, and partnership distributions and income, have the same ownership and income tax characteristics, this is simply incorrect as a matter of partnership and income tax law. n36 The court summarized this situation succinctly when it stated that presumably both corporate owners and individuals would pay taxes on public utility assets they control. Similarly, like a Subchapter C corporation, partners may have deductions or losses that offset the income from a specific public utility asset or which may neutralize the operating income from the asset itself. But this does not preclude such a corporation from obtaining an income tax allowance under the Commission's stand-alone doctrine. n37 Just as there are no rational grounds for granting an income tax allowance on partnership interests owned by a corporation and denying one to those owned by individuals, there are no rational grounds for reaching a different conclusion for the deductions and offsets for taxpaying partners or LLC members.

n36 *See* ATCLLC at 5.

n37 *See City of Charlottesville, supra,* note 12.

39. The Commission further concludes that the alternatives listed at the beginning of this Part III of this policy statement are not practical or are inconsistent with the court's remand. First the Commission agrees with the court's conclusion in *BP West Coast* that the Commission in *Lakehead* did not articulate a rational ground for concluding that there should be no tax allowance on partnership interests owned by individuals, but that there should be one for partnership interests owned by corporations. As the court stated, presumably individual partners pay taxes on their public utility income just as corporate partners pay income tax **[*61,744]** on theirs. The comments summarized in sections A and D of Parts II of this order affirm that common sense observation. The court's rejection of *Lakehead* likewise establishes why the Commission cannot simply limit income tax allowances to partnerships that are wholly owned by corporations, since doing so in effect denies a tax allowance to the partners of a partnership with no corporate ownership.

40. Similarly, there no rational reason to limit the income tax allowance to public utility income earned by a corporation. Public utility income controlled directly by an individual may also be taxed. The partnership entity is simply an intermediate ownership device that leads to the same tax result. Since both partners and Subchapter C corporations pay income taxes on their first tier income, the inconsistency that undermined *Lakehead* applies here as well. Finally, the comments rightly suggest that it would be difficult to establish rates based on a pre-tax rate of return. If the Commission were simply to raise the rates to equalize the pre-tax and after-tax returns, all this would do incorporate a presumed marginal income tax rate into the rate structure. The result is the same for the rate payer although the nominal rate of return is much higher. Moreover, most comparable securities trade on the basis of a corporation's after-tax return on its public utility income. n38 Thus, it would be hard to determine what the appropriate pre-tax return should be based on traded equities alone. Since it is impractical not to give an income tax allowance to any jurisdictional entities due to the problems of determining an appropriate pre-tax rate of return, the Commission again concludes that an income tax allowance should be afforded all jurisdictional entities, provided that the owners of pass-through entities have an actual or potential income tax liability.

N38 As discussed, the investor then receives a dividend and pays a second tax on that income to determine the investor's after tax return. This is somewhat less than the return from a partnership interest that benefits from an income tax allowance.

41. There are three final points that should be discussed in addressing the effect of the court's remand. First, the court concluded that denying a partnership an allowance on the proportion of partnership interests owned by individuals would not prevent over-recovery by such individuals, since any tax savings would be distributed in proportion to all the partnership interests. The Commission recognizes that rate payers should not incur the expense of an income tax allowance to the extent that an owning partner or LLC member has no actual or potential income tax liability for the income generated by the interest it owns. As WPPI and ATCLLC explain, this can be avoided by limiting the income tax allowance to a blended rate that reflects the income tax status of the owning interest. n39 The use of the weighting approach assures that the rate payers will not be charged more than the actual tax cost the investors incur regardless of the ownership form. The problems of over- and

under-recovering alluded to in the court's order can be addressed through the distribution provisions of the partnership agreement. n40

n39 WPPI at 5-6 and 12-13; ATCLLC at 6.

n40 The court was concerned that the income tax allowance granted for corporate partners would increase the cash available for distribution to all partners, thus providing an increased return to the individual partners that the *Lakehead* doctrine was intended to prevent. Adjustments within the partnership agreement should assure that this does not result while preserving the incentives to establish flexible investment vehicles.

42. Second, whether a particular partner or LCC member has an actual or potential income tax liability, and what assumptions, if any, should determine the amount of the related tax rate, are matters that should be resolved in individual rate proceedings. This is a fact specific issue for which the relative data is uniquely within the control of the regulated entity. Thus, any pass-through entity desiring an income tax allowance on utility operating income must be prepared to establish the tax status of its owners, or if there is more than one level of pass-through entities, where the ultimate tax liability lies and the character of the tax incurred. This could be done through determining the distribution of ownership interests at the end of the standard test year. Finally, some parties assert that this proceeding is tainted by *ex parte* communications that preceded the issuance of the Commission's December 2, 2004 notice of inquiry. These are without merit as the relevant communications were filed in the appropriate dockets and the Commission's notice of inquiry provided all interested parties an opportunity to comment. The decision here is based on the record developed by those comments.

The Commission orders:

The income tax allowance policy adopted in the body of this policy statement shall be applied in pending and future rate proceedings of public utilities subject to the Commission's rate jurisdiction.

By the Commission.

Legal Topics:

For related research and practice materials, see the following legal topics:
Energy & Utilities LawAdministrative ProceedingsU.S. Federal Energy Regulatory Commission-General OverviewEnergy & Utilities LawGrants & ReservationsJoint Ventures & Partnership-sEnergy & Utilities LawTaxation

CERTIFICATE OF SERVICE

I, Lisa Vieland, certify that I have on this 26th day of April 2007 caused a copy of the foregoing

CONCURRENT OPENING BRIEF OF SFPP, L.P.

to be served on all known parties to C.97-04-025, C00-04-013, A.00-03044, A.03-02-027, A.04-11-017, A.06-01-015, A.06-08-028 and C. 06-12-031 listed on the most recently updated service list available on the California Public Utilities Commission website, via email to those listed with email and via U.S. mail to those without email service. I also caused courtesy copies to be hand-delivered as follows:

Commissioner Michael R. Peevey
President
California Public Utilities Commission
State Building, Room 5218
505 Van Ness Avenue
San Francisco, California 94102

ALJ Douglas M. Long
California Public Utilities Commission
State Building, Room 4012
505 Van Ness Avenue
San Francisco, California 94102

I declare under penalty of perjury that the foregoing is true and correct. Executed this 26th day of April, 2007 at San Francisco, California.

/s/ Lisa Vieland
Lisa Vieland

2539/001/X88547.v1

Service List C9704025
Last Updated 4-10-07

Related Cases: C00-04-013, A.00-03044, A.03-02-027, A.04-11-017, A.06-01-015, A.06-08-028 and C. 06-12-031

JOHN B MERRITT
TRAVIS & GOOCH
Exxon-Mobil & BP
34820 N DESERT RIDGE DR.
SCOTTSDALE, AZ 05282-1104

RICHARD E. POWERS, JR.
repowers@venable.com

STEVEN A. ADDUCCI
saadducci@venable.com

MARK R. HASKELL
ATTORNEY AT LAW
TRAVIS & GOOCH
SUITE 1010
1101 15TH STREET, N.W.
WASHINGTON, DC 20005-5002

ELISABETH R. MYERS
emyers@blackwellsanders.com

GEROGE L. WEBER
WEBER & ASSOCIATES, P.C.
Chevron Texaco Products Company
SUITE 600
1000 CONNECTICUT AVEUNE., N.W.
WASHINGTON, DC 20036

MARCUS W. SISK, JR
DORSEY & WHITNEY LLP
ConocoPhillips Company
SUITE 1250
1050 CONNECTICUT AVENUE, N.W.
WASHINGTON, DC 20036

MATTHEW A. CORCORAN
mcorcoran@goldstein-law.com

MELVIN GOLDSTEIN
mgoldstein@goldstein-law.com

ROBERT W. KNEISLEY
ASSOCIATE GENERAL COUNSEL
SOUTHWEST AIRLINES CO.
1901 L STREET, N.W., SUITE 640
WASHINGTON, DC 20036

R. GORDON GOOCH
gordon_gooch@earthlink.net

ANDREW J. DALTON
VALERO ENERGY COMPANY
ONE VALERO PLACE, ROOM 264
SAN ANTONIO, TX 78212-3186

BARRON DOWLING
bdowling@tsocorp.com

CHARLES FERGUSON
ferguson.charles@dorsey.com

JAMES D. SQUERI
jsqueri@goodinmacbride.com

JEFFREY P. GRAY
jeffgray@dwt.com

D. T. SHERMAN
ASSOCIATE GENERAL COUNSEL
CHEVRON PRODUCTS COMPANY
PO BOX 5044
SAN RAMON, CA 94583

EVREN ERGIN
eergin@lehman.com

GLENN S. BENSON
ATTORNEY AT LAW
TEXACO, REFINING AND
MARKETING, INC.,
1101 15TH STREET N W SUITE 1010
WASHINGTON, DC 20005

NOREEN M. TAMA
noreen.m.tama@exxonmobil.com

JENNIFER LIGHT MCGRATH
MOBIL OIL CORPORATION
3225 GALLOWS ROAD, ROOM 8B115
FAIRFAX, VA 22037-0001

THOMAS A. NOTO
ATTORNEY AT LAW
MOBIL OIL CORPORATION
ROOM 8B313
3225 GALLOWS ROAD
FAIRFAX, VA 22038-0001

BARBARA HICKEL
EQUILON ENTERPRISES
Equilon Enterprises
910 LOUISIANA
HOUSTON, TX 77210

ELIZABETH E. ATLEE
Elizabeth.atlee@bp.com

JOHN BURKHOLDER
burkee@cts.com

BRUCE FOSTER
bruce.foster@sce.com

EDWARD W. O'NEILL
edwardoneill@dwt.com

JUDY PAU
judypau@dwt.com

DOUG GARRETT
COX CALIFORNIA TELCOM, LLC
2200 POWELL STREET, SUITE 1035
EMERYVILLE, CA 94608-2618

PAUL M. PREMO
paulpremo@msn.com

RONALD BROBERG
PRESIDENT
TRUCKING SUPPORT SERVICES
TEAM
PO BOX 1608
PLACERVILLE, CA 95667

LARRY E. FARRENS
CALIFORNIA TRUCKING
ASSOCIATION
3251 BEACON BOULEVARD
WEST SACRAMENTO, CA 95691

ANDREW BROWN
abb@eslawfirm.com

SCOTT BLAISING
blaising@braunlegal.com

Vahak Petrossian
vap@cpuc.ca.gov

Douglas M. Long
dug@cpuc.ca.gov

Maurice Monson
mdm@cpuc.ca.gov

Paul Wuerstle
pwu@cpuc.ca.gov

PUC/X88549.v1